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**Multistate Audit Procedures Manual**
**Table of Contents**

**1000 INTRODUCTION & GENERAL INFORMATION ..... 9**
1010 INTRODUCTION ..... 10
1020 TO ORDER THE MULTISTATE AUDIT PROCEDURES MANUAL ..... 11
1030 AUDIT OBJECTIVES ..... 12
1035 AUDIT STANDARDS ..... 13
1040 RESOURCE CONSIDERATIONS ..... 14
1050 AUDIT PRIORITIES ..... 15
1060 TERMS AND DEFINITIONS ..... 16
**2000 CONFIDENTIALITY & DISCLOSURE ..... 17**
2010 CONFIDENTIALITY ..... 18
2020 DISCLOSURE OF INFORMATION ..... 19
2030 DISCLOSURE OF CORPORATE TAXPAYERS' FILES ..... 20
2040 OTHER STATE TAX AGENCIES REQUESTS FOR INFORMATION ..... 22
2050 THIRD PARTY CONTACTS ..... 23
2060 CRITERIA FOR REFERRAL OF CASES TO THE TAXPAYER ADVOCATE BUREAU ..... 25
2070 TAXPAYER BROWSING PROTECTION ACT (H.R. 1226) ..... 26
2080 INTERNET MAIL ..... 27
2090 OFF-SITE SECURITY CONSIDERATIONS ..... 28
**3000 PRE-AUDIT ..... 29**
3001 COORDINATION OF COMPREHENSIVE AUDIT ..... 30
3010 AUDIT EXPECTATIONS ..... 31
3015 CUSTOMER SERVICE ..... 32
3050 FIELD REFERRALS ..... 34
3060 SURVEYS ..... 36
3070 SURVEYING CASES AFTER TAXPAYER CONTACT ..... 37
3080 GUIDELINES FOR PREVIOUSLY AUDITED TAX YEARS ..... 39
3085 SETTLEMENTS AND CLOSING AGREEMENTS ..... 41
3090 TRUCK AUDITS FOR DESK UNIT ..... 44
3120 HOW TO REQUEST TAX RETURNS ..... 45
3130 LIMITED RETENTION DATE (LIM) DATES ..... 48
3140 RETURNS RECEIVED FROM THE TAXPAYER IN THE FIELD ..... 49
**4000 AUDIT WORK IN PROGRESS (WIP) ..... 50**
4010 AUDIT WORKPAPER PREPARATION ..... 51
4020 WORKPAPER PREPARATION STANDARDS ..... 52

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated**

4030 UNIFORM FORMAT ..... 53
4035 INDEX TO AUDIT FILE, FORM FTB 6869A ..... 54
4040 AUDIT PROGRAM WORKSHEET, FORM FTB 6833 ..... 55
4050 EVENT LOG ..... 56
4060 AUDIT ISSUE SECTION, FORM FTB 6870B ..... 57
4065 AUDIT ISSUE SECTION – VERIFICATION, FORM FTB 9910 ..... 58
4070 AUDIT PLAN ..... 59
5000 WORKING WITH TAXPAYERS ..... 64
5010 WORKING WITH TAXPAYERS ..... 65
5015 OPENING CONFERENCE ..... 67
5020 CORRESPONDENCE ..... 75
5030 INFORMATION DOCUMENT REQUESTS ..... 77
5050 FOLLOW-UP & KEEPING THE AUDIT CURRENT ..... 82
5060 TAXPAYER FAILS TO RESPOND TO AN AUDIT ..... 86
5065 AUDIT ISSUE PRESENTATION SHEETS (AIPS) ..... 87
5070 CONCLUDING THE AUDIT WITH THE TAXPAYER ..... 92
5080 POSITION LETTER ..... 95
5090 CLOSING CONFERENCE ..... 99
6000 CLOSING THE AUDIT ..... 103
6010 THE AUDIT REPORT PACKAGE ..... 104
6020 ADJUSTMENT SCHEDULES ..... 107
6030 NARRATIVE REPORT ..... 108
6040 OUTLINE FOR NARRATIVE REPORT ..... 110
6050 "WALKER LETTER SITUATIONS" ..... 117
6060 NOTICE OF PROPOSED ADJUSTED CARRYOVER AMOUNT ..... 120
6065 NO CHANGE AUDITS ..... 124
6070 UNAGREED ADJUSTMENTS ..... 125
6080 JEOPARDY ASSESSMENT ..... 126
6090 NOTICE OF ACTION ON JEOPARDY ASSESSMENTS ..... 128
6100 PAYMENTS RECEIVED IN THE FIELD ..... 129
6110 PAYMENTS RECEIVED AT CENTRAL OFFICE ..... 130
6120 MINIMUM ADJUSTMENT ..... 131
6130 NOTICE OF REVISION ..... 132
6140 POST-NPA CASES ..... 133
6150 AUDIT SUBJECT TO REVIEW ..... 134
6160 DEFERMENT OF FINAL ASSESSMENT OF NPAS ..... 139
6170 SUSPENDED CORPORATIONS ..... 140
7000 FORMS & INSTRUCTIONS ..... 142
7010 REQUEST FOR FIELD ACTION (FORM FTB 7024) ..... 143
7020 NPA WORKSHEET (FORM FTB 6830-BCT) ..... 145
7025 REVENUE CODES ..... 157

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated

7030 AUDIT ISSUE CODES....160
7040 NAME AND ADDRESS OF TAXPAYER....165
7050 CLAIM RECOMMENDATIONS (FORM FTB 6638)....167
7060 WATER'S-EDGE ELECTION FEE....169
7070 AUDIT REPORT COVERSHEET (FORM FTB 6430)....171
7080 AUTHORIZATION FOR SINGLE NOTICES (FORM FTB 4523B)....173
7090 RUSH ACTION SLIP (FORM FTB 7011)....175
7110 THE ABATEMENT/REFUND MEMO (FORM FTB 6163)....176
7120 SUPPLEMENTAL ASSESSMENTS (FORM FTB 6213A AND/OR FORM FTB 5903)....177
7130 CORPORATION MEMORANDUM OF REMITTANCE (FORM FTB 6352)....179
7140 NOTICE OF ACTION / REVISION....180
8000 INTEREST & PENALTIES....182
8010 SUMMARY OF PENALTIES....183
8020 DELINQUENT PENALTY (SECTION 19131)....184
8030 REASONABLE CAUSE FOR THE WAIVING DELINQUENCY PENALTY....185
8040 PENALTY FOR FAILURE TO FURNISH INFORMATION/FILE ON DEMAND (SECTION 19133)....187
8050 REASONABLE CAUSE FOR WAIVING THE PENALTY FOR FAILURE TO FURNISH INFORMATION ON DEMAND/FILE ON DEMAND....189
8060 NEGLIGENCE PENALTY (SECTION 25934-35 -A REPEALED IN 1990)....190
8070 ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX (SECTION 19164)....191
8080 EXCEPTIONS TO THE ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX....192
8085 FRAUD (SECTION 19164(C))....193
8100 FAILURE TO FILE ANNUAL STATEMENT (SOS PENALTY SECTION 19141)....194
8110 UNDERPAYMENT PENALTY (SECTION 19132)....195
8120 UNDERPAYMENT OF ESTIMATED TAX (SECTION 19142)....196
8130 INTEREST....197
8140 INTEREST ABATEMENT....199
9000 STATUTE OF LIMITATIONS....200
9010 STATUTE OF LIMITATIONS - IN GENERAL....201
9020 SPECIAL STATUTE....203
9030 STATUTE OF LIMITATION CHART....204
9035 EIGHT-YEAR STATUTE OF LIMITATIONS FOR TAX SHELTERS....208
9040 OFFSET OF BARRED REFUND....211
9045 RECOVERY OF ERRONEOUS REFUNDS....212
9050 SECURING STATE WAIVERS....213
9060 WAIVER FOR FORMER MEMBERS OF A COMBINED REPORT....217
9070 WAIVERS FOR CORPORATE GROUPS IN DIVERSE BUSINESS ACTIVITIES....218
9080 FACSIMILE (FAX) WAIVERS AND POWERS OF ATTORNEY....219

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated

9090 SECURING WAIVERS ON DELINQUENT RETURNS....220
9100 FEDERAL WAIVER....221
9110 PROCEDURES FOR ACCEPTING MODIFIED WAIVERS....223
10000 CLAIMS, REFUNDS & OVERASSESSMENTS....225
10010 CLAIMS....226
10020 CLAIMS - STATUTE OF LIMITATIONS....233
10030 AUDIT PROCEDURES AND CLAIM RECOMMENDATIONS....234
10040 REFUNDS, CANCELLATIONS AND OVERASSESSMENTS....243
10050 CLAIMS – RARS AND PENDING FEDERAL....245
10060 OFFSET CASES....247
10070 BARRED OFFSET - SECTION 19314....249
10080 ABATEMENT/REFUND OF TAX AND PENALTIES * * * * * * * * * * *....250
10090 ERRONEOUS REFUND....251
10100 CLAIMS CONTROL SYSTEM....252
10110 APPEALS FROM CLAIM DENIALS – PROCEDURES....253
11000 PROTEST & APPEAL....254
11010 RECORDING A PROTEST....255
11020 PROTESTS & APPEALS PROCESS....256
11030 CLASSIFICATION OF PROTESTS....258
11040 DOCKETED PROTEST....259
11050 UNDOCKETED PROTEST....260
11060 PROTESTS - PENDING FEDERAL (PF)....261
11070 PROTESTS - FIELD AUDIT....262
11080 REQUIREMENTS FOR VALID PROTEST....263
11090 PROTESTS - TIMELINESS....264
11100 PROTESTS - SUSPENDED CORPORATIONS....265
11110 PROTESTS - HEARING....266
11120 PROTESTS RETURNED FOR FURTHER DEVELOPMENT....267
11130 PROTESTS - CORRECTION OF NOTICES....270
11140 REINSTATEMENT OF A NOTICE TO PROTEST STATUS....272
11150 FOLLOW-UP ON NON-FINAL NPAS....273
11160 APPEALS – RECORDING AND DISPOSITION....274
11170 APPEALS FROM NOTICES OF ACTION - GENERAL INFORMATION....275
12000 REVENUE AGENT'S REPORT (RAR)....276
12010 RAR - GENERAL INFORMATION....277
12020 RAR RECEIVED IN THE FIELD....278
12030 INFORMATION COPIES TO IRS....279
12040 REQUEST FOR FEDERAL RETURNS AND/OR AUDIT REPORT....280
12050 CORRELATING THE RAR WITH TAXPAYER'S FILE....282
12060 RAR - AUDIT....283

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated

12065 FEDERAL ADJUSTMENTS WITH A CALIFORNIA TAX EFFECT IN DIFFERENT YEARS....286
12070 PENDING FEDERAL....290
12080 RAR - TAXPAYER NOT IDENTIFIED....292
12090 RECORDING RAR - REVENUE....293
12100 RAR INDICATOR CODES....294
12110 FEDERAL ADJUSTMENTS BASED ON COPIES OF FRANCHISE TAX BOARD NPAS....295
12120 RAR - PROTESTS....296
13000 WATER'S-EDGE....297
13010 WATER'S-EDGE - GENERAL....298
13020 PROCEDURES FOR PROCESSING WATER'S-EDGE CONTRACTS – INTRODUCTION....299
13030 PROCESSING OF WATER'S-EDGE CONTRACTS....301
13040 TERMS/ABBREVIATIONS....303
13050 WATER'S-EDGE - FIRST YEAR ELECTIONS, CONTRACT ATTACHED....304
13060 WATER'S-EDGE - FIRST YEAR ELECTIONS, CONTRACT NOT ATTACHED....306
13070 REPORTING - WATER'S-EDGE ELECTION PRE-1994....308
13090 WATER'S-EDGE - FOREIGN PARENT LIST....310
13100 WATER'S-EDGE - BOX CHECKER RETURNS - BACKGROUND....311
13110 SUPPORT STAFF - PROCESSING WATER'S-EDGE FIRST-YEAR RETURNS....312
13120 COMPLETION OF FORMS - CANCELLATION OF WATER'S-EDGE PENALTIES....313
13130 WATER'S-EDGE FAILURE TO FURNISH INFORMATION PENALTY....314
14000 BANKRUPTCY....316
14010 BANKRUPTCY UNIT....317
14020 IDENTIFYING A TAXPAYER IN BANKRUPTCY....318
14030 BANKRUPTCY TYPES....320
14040 IMPORTANT DATES & PERIODS....321
14050 PRIOR BANKRUPTCY LAW....325
14060 CURRENT BANKRUPTCY LAW....326
14070 PROMPT AUDIT REQUESTS....327
14080 STATUTE OF LIMITATIONS....328
14090 PETITION NUMBER....329
14100 AUDIT BANKRUPTCY PROCEDURES....330
14110 APPLICATION OF FRANCHISE TAX....333
14120 PENALTIES....334
14130 TAX NOTICE PROCEDURES - PRIOR BANKRUPTCY LAW....335
14140 TAX NOTICE PROCEDURES-CURRENT BANKRUPTCY LAW....337
14150 POST NPA - OUT OF STATE PROTEST CASES....338
14160 TAX NOTICE WORKSHEET (NPA, NOA NOD)....339

The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated

14170 BANKRUPTCY CORRESPONDENCE - PROTESTED NPAS, OTHER NON-FINAL NPAS.....340
14180 BANKRUPTCY CORRESPONDENCE - FINAL NPAS.....341
14190 COMBINED REPORT PROCEDURES.....342
15000 POST DISSOLUTION/TAX CLEARANCE.....343
15001 POST-DISSOLUTION /TAX CLEARANCE -IN GENERAL.....344
15010 POST DISSOLUTION GENERAL.....347
15020 AUDIT CONTROL OF DISSOLVED CORPORATIONS.....348
15030 RELATED FOLDERS MISSING.....349
15040 PROCESSING FOLDERS.....350
15050 LATEST RETURN NOT IN FOLDER.....351
15060 RETURNS IN FIELD.....353
15070 REQUESTING CORPORATE FOLDERS.....354
15080 DISSOLUTION OF A CREDIT UNION.....355
15090 REORGANIZATIONS.....356
15100 FILING REQUIREMENTS FOR A MERGER.....357
15110 PROCESSING FINAL RETURN.....358
15120 DISSOLVED PARENT OR "KEY" CORPORATION.....359
15130 COMPUTATION OF FINAL TAX (§23151.1).....360
15140 FIRST YEAR TAX CREDIT.....361
15150 REFUNDS.....362
15160 AUDIT ISSUES.....363
15170 DEFERRED INSTALLMENT SALE INCOME.....364
15180 ACCOUNTS RECEIVABLE.....365
15190 GAIN ON DISTRIBUTION OF ASSETS.....366
15200 SUBCHAPTER S CORPORATION.....367
15210 BAD DEBT RESERVE.....368
15220 NET OPERATING LOSS.....369
15230 DEFINITIONS.....370
16000 BETS.....371
16010 REVENUE CODES.....372
16020 FTB UNIT CODES & REQUESTER CODES.....377
16030 PRE-NPA PROCEDURES.....378
16040 CREATE A NOTICE ON BETS.....383
16050 PREVIEW A NOTICE ON BETS.....389
16060 CHANGE A NOTICE ON BETS.....391
16070 DELETE A NOTICE ON BETS.....393
16080 HOW TO CHANGE A MANUALLY ASSESSED PENALTY ON BETS.....394
16090 HOW TO CHANGE A SYSTEM ASSESSED PENALTY ON BETS.....397
16100 CREATE A CORPORATE ASSUMER RELATIONSHIP ON BETS.....399
16110 CREATE AN INDIVIDUAL ASSUMER RELATIONSHIP ON BETS.....400

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated**

16120 HOW TO CHANGE THE SOL DATE IN R207 ON BETS ..... 402
16130 VIEWING NOTICES IN THE HISTORY LIST ON BETS ..... 403
16140 POST-NOTICE/BETS AFFIRMATIONS* ..... 404
16150 POST-NOTICE/BETS REVISION ..... 406
16160 POST-NOTICE/BETS WITHDRAWALS ..... 409
16170 POST-NOTICE - CONVERTED - AFFIRMATIONS ON BETS ..... 411
16180 POST-NOTICE - CONVERTED - REVISIONS ON BETS ..... 414
16190 POST-NOTICE - CONVERTED - WITHDRAWALS ON BETS ..... 418
16200 MANUAL PROCESSING ..... 421
17000 OTHER PROCEDURES ..... 422
17010 BILL ANALYSIS ..... 423
17030 MULTISTATE TAX COMMISSION REQUESTS ..... 427
17040 OTHER STATE TAX AGENCIES REQUESTS FOR INFORMATION ..... 428
18000 AUDIT TOOLS ..... 429
18010 TELEPHONE CALLS ..... 430
18020 FACSIMILE USAGE (FAX) ..... 431
18025 POWER OF ATTORNEY ..... 434
18030 TAXPAYER REQUESTS COPY OF CORPORATION RETURN ..... 437
18040 TAXES ADMINISTERED - FRANCHISE TAX – NON-QUALIFIED CORPORATIONS ..... 438
18050 CORPORATION IDENTIFICATION NUMBER ..... 439
18060 COMMON FTB ADDRESSES ..... 440
18070 EXPRESS MAIL ..... 441
18080 RESEARCH PROCEDURES ..... 442
18090 OUTSEARCH ..... 444
18100 RESEARCH AND REFERENCE GUIDE ..... 445
19000 PASS ..... 453
19010 INTRODUCTION ..... 454
19020 WORKING CASES IN PASS ..... 455
19030 CREATING CASE UNITS ..... 456
19040 CASES CREATED IN ERROR ..... 458
19050 REQUESTING RETURNS ..... 459
19060 TRANSFERRING CASE UNITS ..... 461
19070 WORKING CASE UNITS WITH DIFFERENT CASE TYPES ..... 463
19080 ACTIVATING THE BETS NOTIFICATION FLAG ..... 464
19090 CHECK IN AND CHECK OUT ..... 465
19100 EVENT LOG ..... 466
19110 CASE UNIT – KEY DATES ..... 467
19120 GENERAL INFORMATION WINDOW ..... 470
19130 TASK PLAN ..... 472
19140 ELECTRONIC WORKPAPER FILES ..... 474
19150 CROSS REFERENCING WORKPAPERS ..... 475

**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated**

**19160 OUTGOING CORRESPONDENCE ..... 477**
**19170 INCOMING CORRESPONDENCE ..... 478**
**19180 NOTICE WINDOW ..... 479**
**19190 WORKING TEAM AUDITS ..... 482**
**19200 INFORMAL REVIEW ..... 485**
**19210 FORMAL REVIEW ..... 486**
**19220 CLOSING CASES ON PASS ..... 487**
**19230 FOLLOW-UP FLAG PROCEDURES ..... 491**
**19240 PRINTING ..... 493**
**19250 PAR TEAM AND CHANGE REQUESTS ..... 494**
**19260 TIME REPORTING ..... 495**

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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# 1000 INTRODUCTION & GENERAL INFORMATION

MAPM 1010 Introduction
MAPM 1020 To Order the Multistate Audit Procedures Manual
MAPM 1030 Audit Objectives
MAPM 1035 Audit Standards
MAPM 1040 Resource Considerations
MAPM 1050 Audit Priorities
MAPM 1060 Terms and Definitions

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## 1010 INTRODUCTION

The **Multistate Audit Procedures Manual** (MAPM) contains procedures and guidelines pertinent to Multistate Tax Audits. The manual is meant to be the primary reference for current audit procedures. However, it does not cover all possible audit situations.

As explained in FTB Notice 1994-8, manuals provided for the guidance of the audit staff are not authoritative, and may neither be cited to support an audit position nor relied upon by a taxpayer. Instead, the manual should be used as an initial step in understanding multistate audit procedures and guidelines.

Auditors should use discretion in deciding what techniques should be used in a particular audit. Furthermore, auditors are strongly encouraged to use their creativity and initiative to develop additional techniques. The audit techniques utilized in a case should be the best audit practices for that particular case. Consistent application of certain techniques such as the use of opening conferences, single question IDRs, and AIPS are generally required in all field cases. However, audit techniques will vary based on what is needed to efficiently resolve the case.

Finally, the audit process is continually evolving as the tax law changes, as new SBE and court cases are decided, and as audit policies and techniques are developed and refined. Statements of law found within this manual reflect the law as of the revision date of this manual. To ensure the continued relevance of this manual, it is important that it be updated to reflect these changes. Any suggestions or corrections are welcomed and should be referred to MSA Technical Resource Section.

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## 1020 TO ORDER THE MULTISTATE AUDIT PROCEDURES MANUAL

### FRANCHISE TAX BOARD STAFF

The Multistate Audit Procedures Manual is available on the Franchise Tax Board Inside Net. Consequently, hard copies should seldom be required by FTB staff. On those rare occasions when printed copies are needed, they may be ordered from Technical Design.

### PUBLIC CUSTOMERS

The Multistate Audit Procedures Manual is available on the Franchise Tax Board Website at [http://www.ftb.ca.gov/manuals/audit/mapm/mapm.pdf].

Printed copies of the Multistate Audit Procedures Manual may be ordered by sending a check or money order payable to the Franchise Tax Board to:

**FRANCHISE TAX BOARD**
**TECHNICAL DESIGN MS B-4**
**P O BOX 1468**
**SACRAMENTO CA 95812-1468**

For the current price, call (916) 845-3280 or write to the above address. You also may request Form FTB 4012 PUBLICATIONS PRICE LIST for a list of publications available for purchase.

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## 1030 AUDIT OBJECTIVES

The primary responsibility for determining the correct amount of tax rests with taxpayers. In accordance with California Revenue and Taxation Code Sections 19501 - 19504, the department has developed an audit program. The goal of the department is to complete cases within 2 years of initial contact, 4 years from the date filed, or within a reasonable period as dictated by the circumstances of the case.

### Purpose Of An Audit

The purpose of an audit is to effectively and efficiently determine the correct amount of tax based on an analysis of relevant tax statutes, regulations and case law as applied to the taxpayer's facts. The procedures and techniques needed to successfully complete an audit assignment will depend on the circumstances in each case. In all cases, established audit objectives and resource considerations govern how the procedures and techniques are utilized, and also the manner in which they are applied. Experience has shown that the best results are achieved through cooperation, effective communications, and setting and adhering to goals throughout the audit process. The BAP Audit Techniques Team, made up of our most successful and experienced auditors, has developed the tools in the following areas that will assist auditors in incorporating Best Audit Practices into their workloads. In this package you will find techniques for optimizing your use of:

- Opening Conference (MAPM 5015)
- Audit Plan (MAPM 4070)
- Status Conferences (MAPM 5050)
- Information Document Requests (MAPM 5030)
- Audit Issue Presentation Sheets (MAPM 5065)
- Position Letters (MAPM 5080)
- Closing Conferences (MAPM 5090)

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## 1035 AUDIT STANDARDS

As recognized professionals, auditors are expected to conduct themselves and their work in a manner that is both fair and effective. Auditors are expected to correctly apply and administer the tax laws in a reasonable, practical, fair and impartial manner. Audits should be conducted in a reasonable manner within the bounds of law, with sound administration, efficiency, courtesy, professionalism, and respect to taxpayers. To achieve these objectives, auditors should conduct audits in a manner, which is not unnecessarily burdensome, costly or intrusive to taxpayers. Our goal is to continually strive for quality and excellence in the services provided to taxpayers.

The audit process consists of identifying issues, obtaining, evaluating, documenting information and arriving at the correct determination, which is supported by a reasonable interpretation of the tax laws. The auditor should strive for clear and timely communication with the taxpayer throughout all phases of the audit process. Audits are to be conducted in adherence with the following audit standards in all cases:

- LEGALITY – Audit activities and conclusions must agree with established laws and legal interpretations.
- OBJECTIVITY – An objective examination of all relevant, available factual data will be made in a fair and unbiased manner.
- TIMELINESS – Audits must be conducted and completed promptly, with a minimum of inconvenience to taxpayers.
- SUPPORTABILITY – Recommendations must be adequately supported, consistent with both the facts and the law.

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## 1040 RESOURCE CONSIDERATIONS

THE RESOURCES AVAILABLE TO THE DEPARTMENT ARE SET THROUGH THE BUDGET PROCESS. AUDITORS ARE EXPECTED TO USE THESE LIMITED RESOURCES EFFICIENTLY AND EFFECTIVELY WITH PARTICULAR ATTENTION TO PLANNING WORK ON THE BASIS OF TAX CHANGE POTENTIAL AND COST BOTH TO THE DEPARTMENT AND TO THE TAXPAYERS.

THE FOLLOWING GENERAL RESOURCE GUIDELINES APPLY IN ALL CASES:

- A LIMITED SCOPE AUDIT SHOULD BE UTILIZED WHEN APPROPRIATE.
- TAXPAYERS CARRY THE BURDEN OF SUPPORTING OVERASSESSMENTS.
- RECOMMENDATIONS MUST BE SUPPORTED BY COMPLETE WORKPAPER FILES AND ADEQUATE DOCUMENTARY EVIDENCE SO THAT PROPOSED AUDIT ADJUSTMENTS WILL BE SUSTAINED AT THE PROTEST AND APPEALS LEVEL.

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## 1050 AUDIT PRIORITIES

Auditors must determine the relative priority of each of their assignments and conduct their activities accordingly. The criteria used in establishing these priorities, in addition to the Resource Considerations in **MAPM 1040**, include the following:

- Statute of Limitations will expire in the near future. All cases must be submitted to review at least four months before the expiration date.
- Collection of tax is in jeopardy: * * * * * * * * * * * * * * * * * * * * * * * * * * * * *
- Taxpayer is subject to suspension.
- There are indications that the taxpayer may be leaving the state.
- Tax Clearances (to permit dissolution or withdrawal).
- Post-dissolution audits. (See **MAPM 15000**.)
- Claims for Refund. (See **MAPM 10000**.)
- Protest Cases. (See **MAPM 11000**.)
- Cases started by another office or auditor and forwarded for completion.
- These audit priorities are general in nature and may vary slightly with each MSA Program Office.

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## 1060 TERMS AND DEFINITIONS

There are terms and definitions used extensively in all phases of multistate audits, and in many cases the terms are statutorily defined. Auditors should develop a working knowledge of these terms and definitions. See MATM 0500 for a compilation of these terms and definitions, as well as commonly used abbreviations.

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## 2000 CONFIDENTIALITY & DISCLOSURE

MAPM 2010 Confidentiality
MAPM 2020 Disclosure Of Information
MAPM 2030 Disclosure of Corporate Taxpayers' Files
MAPM 2040 Other State Tax Agencies Requests For Information
MAPM 2050 Third Party Contacts
MAPM 2060 Criteria for Referral of Cases to the Taxpayer Advocate Bureau
MAPM 2070 Taxpayer Browsing Protection Act
MAPM 2080 Internet Mail
MAPM 2090 Off-Site Security Considerations

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## 2010 CONFIDENTIALITY

All information received or developed during the audit is to be treated as confidential information unless it is specifically made public by law. It is the auditor's responsibility to maintain the security of all confidential data during the audit process and to prevent any unauthorized disclosure. The rules pertaining to the security and disclosure of confidential data can also be found in the Security and Disclosure Manual.

Following are some standards and rules to keep in mind when conducting your audit.

- Do not access, request, acquire, or examine confidential information unless there is a need to do so in the normal course of your audit.
- Do not discuss or disclose confidential information to unauthorized individuals. This includes both written and verbal disclosure.
- Dispose of confidential information using approved destruction methods.
- Protect your user ID and password. You are personally responsible and accountable for all activity occurring under your user ID and password.
- Report any suspected unauthorized use of your user ID or password immediately to your supervisor or data security office.

All unauthorized disclosures should be reported immediately to your supervisor. This includes those observed and overheard, as well as disclosures due to your own actions. Your supervisor needs your account of the disclosure before the taxpayer or department can take action. The supervisor should immediately report the disclosure to the section manager who will report it to the Disclosure Officer within 24 hours.

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## 2020 DISCLOSURE OF INFORMATION

California Revenue and Taxation Code Section 19543 is quite specific as to disclosing information about the business activities of corporate taxpayers. For FTB employees the disclosure of confidential information is limited to authorized individuals and organizations that have a need to know the information in order to perform their jobs. A right to know means “legal right to know the information.” There must be both a need to know and a right to know before authorized disclosure can occur.

Under Section 19543 the following public information is not confidential and may be disclosed to any requestor:

1) Corporate title.
2) Corporate number.
3) Date of commencement of business in this state.
4) Taxable year adopted.
5) Filing date of return.
6) Name, date, and title of individuals signing affidavit to return.
7) Due date of taxes.
8) Taxes unpaid (tax, penalty(s) and interest) (do not provide a breakdown).
9) Entity's address.
10) Private address of officers and directors (only if that information is on the tax return or the Secretary of State file).

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## 2030 DISCLOSURE OF CORPORATE TAXPAYERS' FILES

The following guidelines have been developed for the disclosure of certain taxpayer files (Refer to the Security and Disclosure Manual for additional guidance):

WHAT TO DISCLOSE:

AUDIT FILE: Taxpayers and their authorized representatives may obtain copies of their audit file. This includes the narrative, progress report/event log, and all workpapers and supporting material. However, they may not obtain any document, or portion of a document, that discloses the auditor's opinion, judgment, analysis of the strengths and weaknesses of the proposed assessment, proprietary information (such as dollar thresholds for audit selection or other audit selection criteria), or information from or about third parties unrelated to the taxpayer. In particular, review notes are not subject to disclosure because they typically contain recommendations and analysis of the strengths and weaknesses of a case. This would include review notes of the supervisor and the review staff in the Technical Resource Section.

IRS INFORMATION: The IRS/FTB Exchange of Information Agreement prohibits the disclosure of information received from the IRS to anyone other than the taxpayer or their authorized representative. For example, we cannot provide other states with copies of information we received from the IRS.

AFFILIATED ENTITY INFORMATION: Information from or about an affiliate may be disclosed to the taxpayer or their authorized representative if it is relevant to the determination of the taxpayer's franchise/income tax liability. See R&TC Section 19545. For example, assume Taxpayer A and Taxpayer B are affiliated and filed their California returns on a separate company basis. Audit determines that A and B are unitary. Each taxpayer is entitled to obtain information regarding their affiliates' income and apportionment factor denominators because such information is relevant to the determination of the taxpayer's California franchise/income tax liability.

PROTEST FILE: The protest file for cases handled by the Legal Branch may not be disclosed. Taxpayers and their authorized representatives may, however, obtain copies of the protest file if the case was handled by the audit staff. In general, the information that must be disclosed includes the protest hearing officer's report(s) and all workpapers and supporting material. We are not required to provide copies of any document, or portion of a document, that discloses the hearing officer's opinion, judgment, analysis of the strengths and weaknesses of the proposed assessment, or information from or about third parties unrelated to the taxpayer.

WHEN TO DISCLOSE:

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AUDIT FILE: Copies of audit files will not be provided until the staff in the Technical Resource Section has completed its review. For example, notices of proposed assessment are occasionally issued prior to the case being reviewed in order to protect the statute of limitations. In such situations, the audit file will not be disclosed to the taxpayer until Technical Resource Section completes its review.

PROTEST FILE: Copies of protest files will not be provided until the Notice of Action on Protest has been issued. The protest file for cases handles by FTB Legal Branch may not be disclosed.

The above guidelines should be explained to taxpayers that request a copy of their audit file prior to the case passing review, or that question why items such as review notes were not provided. These taxpayers should be advised that although there is no statutory requirement to disclose audit files to corporate taxpayers prior to the discovery process in Superior Court litigation, long-standing department practice is to disclose non-proprietary information when the audit investigation is complete. This practice generally conforms to the provisions of the Information Practices Act (IPA), which mandates the disclosure of information to individual taxpayers. (CA. Civil Code Section 1798.30-1798.44) The department's position is that the audit investigation is not complete until the completion of the review process.

The cost of furnishing this data should be the actual cost incurred by the department. The Disclosure Office establishes these costs.

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## 2040 OTHER STATE TAX AGENCIES REQUESTS FOR INFORMATION

Other States' requests for information can only be provided by designated Franchise Tax Board employees. Franchise Tax Board designees are authorized to receive, request and disclose confidential tax information with those states with which we have reciprocal agreements. See the Disclosure Office Website for a listing of designated employees * * * * * * * * * * * * *

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## 2050 THIRD PARTY CONTACTS

Guidelines for Complying with R&TC Section 19504.7 (Memo from Paul Usedom, March 31, 2000)

Effective for all third party contacts made after April 7, 2000, the department is required to provide notice to all taxpayers prior to contacting third parties. This requirement is a part of the Taxpayer Bill of Rights Act of 1999 that conformed to federal law. Accordingly, the taxpayer should be notified beforehand and have the opportunity to provide alternative sources of information. The implementation of the workable procedures is still under consideration. The following will serve as interim guidance until the procedures are finalized.

What is a Third Party Contact?

The law defines a third party contact as contacts with "any person other than the taxpayer with respect to determination or collection of the tax liability of such taxpayer." The FTB follows IRS procedures and defines a third party contact as a contact:

- initiated by an employee of the FTB,
- made with a person other than the taxpayer,
- made with respect to the determination or collection of a specific taxpayer's tax liability, and
- where the identity of the taxpayer is disclosed or revealed to the third party.

Taxpayer Notification

The purpose of this provision is to provide the taxpayer the opportunity to volunteer whatever information is sought. This is done by FTB providing notification to the taxpayer before third parties are contacted. Each notification is effective for contacts made within 12 months of the date of that notification. The taxpayer can ask for a list of third party contacts no later than 60 days after the end of the 12-month period.

Generally, our audit activity is directly with a taxpayer or the taxpayer's representative. Some audit programs contact third parties on an as needed basis and often with the taxpayer's approval. Accordingly, it is Audit's policy to provide notice of third party contact only when the audit staff intends to contact third parties. We will not issue notifications if there is no intent to contact third parties.

Due to some pending issues regarding the impact of the Information Practices Act on this provision, the following language should be used when notification is necessary:

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"We may contact third parties to determine or collect your tax liabilities. Subject to privacy laws and your rights as a taxpayer, you may obtain a list of those contacts. For more information, please contact our Disclosure Office, P.O. Box 1468, Sacramento, CA 95812-1468."

Audit Record Keeping Responsibilities

You should document the need for a third party contact, that proper notice has been made to the taxpayer, and maintain the needed information in case it's requested to ensure that the taxpayer's rights are protected.

In summary, we are required to do the following:

- Notice must be given to the taxpayer prior to any third party contact.
- The taxpayer must be provided a reasonable period of time to respond to our notice prior to the third party contact.
- The notice is in effect for 12 months. If third party contacts are to be made after that period, another notice must be issued.
- All third party contacts must be documented in the case file.
- A record of contacts must be provided to the taxpayer upon the taxpayer's request. The taxpayer must make the request to the Disclosure Office within 60 days following the 12-month period.
- This provision of the Taxpayer Bill of Rights is effective for all contacts made after April 7, 2000.

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## 2060 CRITERIA FOR REFERRAL OF CASES TO THE TAXPAYER ADVOCATE BUREAU

Please refer any contacts (i.e., e-mail, telephone, and written correspondence) from the following elected officials to the Taxpayer Advocate Bureau - Liaison Section * * * * * * * * *

- Federal or State Legislators or their staff
- Franchise Tax Board or Board of Equalization members or their staff
- Governor or his staff

Also refer any letters addressed to or containing "cc's" for any of the above or any of the following:

- Gerald H. Goldberg
- Executive Officer
- Chief Executive Officer
- Director
- Taxpayer Advocate Bureau

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## 2070 TAXPAYER BROWSING PROTECTION ACT (H.R. 1226)

The Taxpayer Browsing Protection Act makes unauthorized inspection (or browsing) of federal taxpayer information a felony. The penalty for unauthorized browsing is, "…a fine in an amount not exceeding $5,000, or imprisonment of not more than 5 years, or both, together with the costs of prosecution." The pertinent provisions of the act extend the prohibition to state employees with access to federal information.

NOTE: State employees are subject to the federal law provisions regarding unwarranted disclosure or use of federal tax information or any willful unauthorized inspection of federal tax information that we receive from the Internal Revenue Service.

Effective January 1, 1999, R&TC Section 19542.1 was amended so that any unwarranted disclosure or use of tax return information, or any willful unauthorized inspection of tax return information is punishable as a misdemeanor. The Franchise Tax Board is now required to notify the effected taxpayer, but only if certain criminal charges are filed for the offense.

Previously, the CRTC did not provide that unauthorized inspection of tax return information was considered a misdemeanor, and taxpayer notification occurred only if it was determined that the taxpayer could be adversely impacted by the unauthorized disclosure.

"Inspection" is defined to mean any examination of confidential information. IRC Section 7431 & IRC Section 6103 have comparable provisions except that these offenses can be punishable as a misdemeanor, or a felony charge.

All confidential taxpayer data, including RARs, 6227 requests, etc., are to be concealed at all times from everyone except those people working the case. These documents should not be face up in in-baskets or left on desks unless covered or turned over. If an employee is working on a case and another person comes into their workstation, the person should cover or turn over all documents with names or other identifying taxpayer information. If the employee is away from their desk, taxpayer documents should be turned over, covered or put away in a drawer. At night, all confidential data should be secured in file cabinets, drawers, boxes, or shelving that conceals taxpayer identity. This includes all employees.

The law now says that to simply VIEW taxpayer data where you have NO NEED TO KNOW is unauthorized disclosure.

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## 2080 INTERNET MAIL

We have the ability to receive and send electronic mail over the Internet. This tool can be used to accommodate business-driven needs. However, **confidential information may only be sent to, or received from, a taxpayer or representative via Internet Secure Electronic Communications (SEC).** To use SEC, go to the SEC web page * * * * * * * * * * * * * * * * The web page contains tutorials on how to use SEC and printable PDF procedures prior to using SEC. SEC allows one mailbox per FTB employee. An SEC mailbox cannot be set up for an FTB employee to an external mailbox.

Because regular Internet email may be processed through private service providers and transmitted through unsecured lines, the security and confidentiality of the information cannot be ensured.

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## 2090 OFF-SITE SECURITY CONSIDERATIONS

The audit staff must exercise due diligence to protect the confidentiality of all information including the use of PASS PC equipment and the PASS system. Common circumstances where this is an issue include:

- Leaving the PC on and unattended.
- Using the PASS system and equipment off-site during the course of audit examinations.
- Accessibility to the laptop, tax return and other case related information by family members or friends, while telecommuting.
- Leaving the PC and/or audit records in an unsecured location, such as a vehicle.

In order to protect the security of all confidential information, these guidelines should be followed. They include, but are not limited to the following:

- Do not leave the PC unattended while connected to the system, or when using the PC to work off-line.
- Physically secure the PC so as to reduce the risk of theft.
- Physically secure any diskettes that contain confidential information.
- Auditors should apply the screen-saver password feature.

For more information, see "Statement of Incompatible Activities and Rules of Conduct for Department Employees" (FTB Policy File 4130); "Confidentiality and Security of Data" (FTB Policy 9201); "FTB Computer Access Request Procedures" (FTB General Procedures Manual 7010); FTB Information Security Manual; FTB Disclosure Manual; or Contact the FTB Disclosure Office at (916) 845-3326 or visit the Disclosure Home page at * * * * * * * * * * * * * * * *

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## 3000 PRE-AUDIT

MAPM 3001 Coordination of Comprehensive Audit
MAPM 3010 Audit Expectations
MAPM 3015 Customer Service
MAPM 3050 Desk Audit Field Referrals
MAPM 3060 Surveys
MAPM 3070 Surveying Cases After Taxpayer Contact
MAPM 3080 Guidelines for Previously Audited Tax Years
MAPM 3085 Settlements and Closing Agreements
MAPM 3090 Truck Audits For Desk Unit
MAPM 3120 How To Request Tax Returns
MAPM 3130 LIM Dates
MAPM 3140 Returns Received From The Taxpayer In The Field

The pre-audit phase is vital to the audit process. This is the phase where the auditor determines whether to proceed with the examination or accept the returns as filed. If the determination is made to proceed, this is also the phase where the auditor plans the audit and performs the preliminary work. Proper attention to the pre-audit procedures will improve the quality of the audit and help reduce total audit time. See the MATM for an expansion of the pre-audit procedures.

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## 3001 COORDINATION OF COMPREHENSIVE AUDIT

The goal of the audit program is to provide quality audit products through coordinated efforts throughout the Audit Division by ensuring audits are conducted in accordance with the Principals of Tax Administration and Best Audit Practices. An important step in achieving this objective is to identify all significant issues at the beginning of the audit so they can be effectively addressed in a timely manner. An efficient way to accomplish this on issues transcending the Division is to encourage communication among the staff at the lowest possible level.

In furtherance of the communication process, various Program areas within the Division have designated supervisors and/or specialists who will service as initial contacts for coordinating audit selection modeling, assistance with coordinating joint audits and providing technical direction. These individuals and their respective areas are:

| **Multistate Desk Audit:** | |
|---|---|
| * * * * * * * | **S-Corps** |
| * * * * * * * * * | **Partnerships** |
| * * * * * * * * * * * * * * * * * * * * | **C-Corps** |

| **Personal Income Tax Program:** | |
|---|---|
| * * * * * * * | **Residency** |
| * * * * * * * * * | **Estates & Trusts** |
| * * * * * * * * * * * * * * * * * * * * * | **PIT** |

| **Pass Through Entities Program:** | |
|---|---|
| * * * * * * * | **S-Corporations** |
| * * * * * * * * | **Partnerships** |

| **C Corporation Progam:** | |
|---|---|
| * * * * * * * | **Central Office** |
| * * * * * * * | **Field Operations** |
| * * * * * * * | **Field Operations** |
| * * * * * * * | **Field Operations** |

Both MSA and GTA Technical Resource Section staff are also available to provide technical assistance. * * * * * * * * * * * * * * * * * * *

## 3010 AUDIT EXPECTATIONS

Auditors are expected to effectively manage their inventory, plan their work, consider the materiality of issues and conduct examinations with the least intrusion to taxpayers. Auditors should apply the following guidelines:

- Avoid opening new audits with less than 6 to 12 months left before the statute of limitation expires. * * *

## 3015 CUSTOMER SERVICE

In the audit environment, Quality Customer Service is to listen, recognize, and respect customers' needs and provide timely assistance. The Franchise Tax Board continues to seek quality and excellence in the service it provides to its customers.

Our current audit focus is to deliver customer service through the completion of quality audit cases, shortened audit timeframes, and auditing more current years. To move forward, we must continue to place a greater emphasis on customer service while ensuring compliance. The Audit & Executive Programs Branch will emphasize the following in the coming years:

- Improve Customer Service - Increase auditors' awareness of customer service and it's application during audit activities.
- Continue Current Focus - Produce quality audits, shorten audit timeframes, and audit current years.
- Maintain Timely Follow-Ups and Meet Deadlines (letters, phone calls, etc.).
- Minimize Intrusiveness - Use all available resources to minimize information requests; be flexible in accepting alternative documentation; apply consistent & clear application of law; focus on education and compliance to measure benefits and efficiencies.
- Heighten Professionalism in the Workplace - Improve communication; respect individuality & ideas; provide equal opportunities for staff.
- Continue Development of Staff - Identify & address staff needs (training, opportunities, special projects); develop staff awareness of taxpayer/representative perspective.

Establishing a positive working relationship with the taxpayer and/or representative, that is conducive to the effective and timely completion of the audit, is of critical importance. To create an atmosphere that encourages positive working relationships, auditors should adhere to the audit standards of Legality, Objectivity, Timeliness and Supportability.

During the course of interaction with the taxpayer and/or representative, effort should be directed toward ensuring that:

- Auditors strive for clear and timely communication with the taxpayer throughout all phases of the audit process.
- The purpose of the audit and the legitimate need for the information requested be conveyed to, and understood by, the taxpayer. This includes discussing with the taxpayer, alternative sources of information that could satisfy our need for information.
- The timely evaluation of audit data and the resulting determinations are made in a fair and impartial manner.

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- Our program objective is to be efficient. Therefore, IDRs should be limited to necessary information and look at minimizing the time and cost to both the taxpayer and FTB, while still maintaining our audit quality standards.
- The audit progresses with a minimum of inconvenience to the taxpayer. This includes obtaining information from third party sources in order to minimize the inconvenience (see **MAPM 2050**, Third Party Contacts). Auditors should always keep in mind the other available sources of information, which could make an Information/Document Request (IDR) unnecessary.
- The final audit recommendations are supported by both the facts and the law and are conveyed to, and understood by, the taxpayer.
- The auditor should always communicate the results of the audit in writing to the taxpayer, and provide the taxpayer with the opportunity to rebut any findings. Audit Issue Presentation Sheets (AIPS) should be issued as soon as a material, adjusted issue is completed.

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## 3050 FIELD REFERRALS

After properly scoping the returns, and an audit issue has been identified, the desk auditor must decide if the audit should be completed as a field audit or a desk audit.

### FIELD REFERRAL CRITERIA

Below are some of the factors that make good field referrals:

- When the need for a detailed examination of the taxpayer's books and records appears necessary or practical to properly complete the audit.
- RARs, Claims for Refund and Amended Returns, when the year in question is already under audit in Multistate Field.
- Returns requested by the Multistate Field Unit.
- When the taxpayer requests that the case be handled in the field, the request will generally be granted unless a field audit does not appear warranted, or the matter can be handled satisfactorily by correspondence.
- When the returns, prior to the audit years, are in the field. Before referring these returns/documents to a Multistate Field Unit, call the auditor in charge of the audit to ask if the subsequent year returns are wanted.
- When the Legal Branch requires additional information not contained in the field audit report and the data cannot be obtained by correspondence.
- When the returns are identified as a major case. Major cases are those listed on the Fortune 500 and other cases identified by program offices. * * *

c) Capitalized rents discrepancy with the property factor formula.

6) Claims if:
   a) The claim is based on a field audit.
   b) The original return is in the field and the auditor assigned the case has been contacted and agrees to handle the claim.
   c) The original return is in the field and it has not yet been assigned to a field auditor.
   d) The claim amount is large and the claim issues warrant a field examination.
   e) The claim is for a major case taxpayer.

This is NOT an all-inclusive list. Any unusual item can be sent to the field for audit. Check with your lead auditor or supervisor.

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## 3060 SURVEYS

Returns accepted without further consideration are referred to as "surveys." Surveys are identified by "S/(auditor's initials)" on the upper right-hand corner of the first page of the corporation return. Some field offices may indicate a survey by a stamp "Surveyed." While the decision to survey a return is usually delegated to the auditor, in certain situations the supervisor may review the recommendation. Since the field criteria differs from desk audit, the desk auditor should scope returns surveyed in the field for potential desk audits.

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## 3070 SURVEYING CASES AFTER TAXPAYER CONTACT

In some cases, the taxpayer is contacted by phone or by correspondence and requested to provide annual reports, federal returns or public information necessary for performing the test check during the scoping process. In other cases, the auditor will conduct a field visit to prepare the test checks. If the results of the test check do not warrant pursuit of the examination, then the case is closed without any substantive audit work having been performed. Unless the taxpayer has been clearly informed that the information has been requested only to determine whether or not to conduct an audit, rather than for normal audit purposes, they may be under the mistaken impression that an audit is underway. This may create problems if issues on the taxpayer's return are discovered at a later date and the taxpayer accuses the department of re-opening the audit.

It is important that we clearly communicate the purposes of our requests to the taxpayer. The following wording is suggested:

> The taxpayer's returns for TYEs xx/xx - xx/xx are being considered for possible audit. The determination whether to conduct an examination will be made based upon a preliminary analysis of the taxpayer's financial data. Please provide the following information to enable us to perform this analysis:

There is a fine line between obtaining information necessary to complete the scoping process, and actually beginning an audit. Generally, the documents requested at this stage should be limited to public information (such as annual reports or SEC Form 10-Ks), information that could be obtained through third party sources (federal tax returns), or information that should have been attached to the California return (missing schedules or supporting information). If you request documents that go beyond this threshold, then the audit has started.

If the taxpayer has already been contacted and the tax potential revealed by the test checks does not warrant pursuit of the audit, the taxpayer should be notified. Since a "no change" letter implies that the return was examined, it is inappropriate to issue a no change letter in this situation. Instead, the taxpayer should be given the following notification:

> Based upon staffing limitations and the results of the preliminary analysis, an audit of TYEs xx/xx - xx/xx will not be conducted at this time. A "no change" letter will not be issued since an audit was not conducted. The returns will remain subject to audit until the expiration of the statute of limitations.

Since the test check is only an audit selection tool and may vary considerably from actual audit results, there is no need to notify taxpayers of potential refunds revealed by a test check as long as the taxpayer has not yet been contacted. Once taxpayers have been contacted and are aware that an auditor is

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looking at their returns, they should be informed if a reasonable possibility of a refund exists. The auditor should use judgement in determining whether the refund potential is reasonable. When notifying the taxpayer, it is important to stress that no audit work has been performed and that it is the taxpayer's responsibility to file a claim for refund and provide the documentation necessary to develop the facts. See **MAPM 6050** for samples of "Walker" letters.

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## 3080 GUIDELINES FOR PREVIOUSLY AUDITED TAX YEARS

In general, audited years should not be reopened. However, there are exceptions such as a material change in fact. The FTB has the statutory authority to examine any books, papers, or other data to ascertain the correctness of any return. In addition, there is no statutory limit on the number of audits per return. However, taxpayers should not be subjected to unnecessary audits. Therefore, audited years should only be reopened in the following limited circumstances:

- Misrepresentation of a Material Fact - Reopening an audit is justified when there is misrepresentation of a material fact, evidence of fraud, malfeasance, collusion, or concealment. This does not include development of a new audit perspective. Discoveries of information or issues missed by the prior audit are not considered misrepresentations of facts unless it can be demonstrated that the taxpayer deliberately withheld requested information;

- A Clearly Defined Substantial Error Based on an Established FTB Position - An audit may be reopened if the prior closing involved a clearly defined substantial error based on an established FTB position existing at the time of the previous audit. An error is clearly defined if it is readily apparent as opposed to being vague or uncertain.

  Substantial refers to the dollar amount of tax that would not be assessed if the case were not reopened. Substantial will be determined on a case-by-case basis, considering all the facts and circumstances relating to the materiality of the error.

  To be an established FTB position, the position must have been clear (not in the developmental stage) at the time of the previous audit. Examples of an established FTB position would include an Audit Branch Procedure Statement, a position taken in an FTB Notice, or a finding in a Legal Ruling.

- A Serious Administrative Omission - A serious administrative omission occurs when failure to reopen a closed audit could;
  1. Result in serious criticism of FTB's administration of the tax law;
  2. Establish a precedent that would seriously hamper subsequent attempts by FTB to take corrective action; or
  3. Result in inconsistent treatment of similarly situated taxpayers.

Exceptions to the General Rules discussed above:

- Carryover Years - A credit carryover, net operating loss carryover, or similar carryover may be audited in the year the carryover is used even though the year in which the credit or loss originated is not within an open statute of limitations. To the extent the carryover is incorrectly

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reported, it should not be allowed to reduce tax in the current audit year or future years.

- Closing Agreements - If an agreement has been reached between the taxpayer and the department covering the treatment of certain items, this treatment should be followed for all tax years specifically stated in the closing agreement unless the auditor finds a material difference in facts or there has been a change in the relevant statute, regulations, or case law. If the auditor has a case that has these circumstances, the auditor should first consult with the audit supervisor before proceeding with disregarding a Closing Agreement.

- Surveys - When a return is classified as a survey, it merely indicates the return was not selected for audit. Consequently, an audit after a survey does not constitute reopening of an audited year.

- Post NPA Development - After a proposed assessment or an over-assessment is issued, the audit may be resolved with further factual development or law application (could include hearing officer, settlement or appeal attorney). The gathering of facts related to the assessment does not constitute reopening the audit of the return.

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## 3085 SETTLEMENTS AND CLOSING AGREEMENTS

Settlement Agreements and Closing Agreements are currently authorized as a means to settle any matter pertaining to tax or civil tax disputes. The purpose of the Settlement Program is to negotiate settlements of civil tax matters consistent with a reasonable evaluation of the costs and risks associated with the litigation of these matters. These agreements provide the Franchise Tax Board and the taxpayer an opportunity for a quick and expedient resolution. Depending when the agreements were approved and whether specific issues were addressed in the agreements, the agreements may have an impact on current or subsequent examinations.

*Closing Agreements*

The California Revenue and Taxation Code section 19441 authorizes the Franchise Tax Board or a member of its staff designated to do so to enter into a closing agreement with a corporation to settle any matter pertaining to tax. The agreement is considered final and conclusive, and except in case of fraud or misrepresentation of a material fact, may not reopened, modified, set aside or disregarded.

*Settlement Agreements*

The California Revenue and Taxation Code section 19442 provides the Franchise Tax Board with the authority to enter into settlement agreements to settle civil tax matters in disputes that are the subject of protests, appeals or claim for refund, consistent with a reasonable evaluation of the costs and risks associated with the litigation of these matters. The 3-member Franchise Tax Board is also required to meet specific time constraints to act on any recommendations for settlement. Settlements not acted upon within 45 days after being submitted to the 3-member Franchise Tax Board are deemed approved. In addition, all settlements entered into are considered final and may not be appealed, unless upon a showing of fraud or misrepresentation of a material fact.

On September 17, 1999, a general policy statement was issued to explain that settlements were limited only to the settled actions and would not impact any other years or other actions for the same years. The settlement years were considered closed as to the issues in dispute with the exception of final federal determinations. Therefore, closing agreements were used for other items that impacted other years or actions for the settled years. Examples of items that impacted other years would be the apportionment factors, the ending balance of the bad debt reserve, carryover adjustments, etc.

For settlements approved on or after January 1, 2003, the settlement provisions were modified. The new provisions provide that settlements are now to include other items or matters that were previously included in a closing agreement. Due to the change in law, a new policy statement was issued on July 17, 2003 providing that settlement agreements are currently considered final and conclusive to the same extent of a closing agreement. Therefore, it is now the general policy of the settlement bureau that the settlement years will be closed, except for final federal determinations, and

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amounts due and payable as of the date the taxpayer signs the settlement agreement, barring further assessments by the Franchise Tax Board and claims for refund.

**Compromise Agreements**

Do not confuse a compromise agreement with a settlement agreement. A compromise agreement is clearly distinguished from a settlement agreement in that a taxpayer is not disputing the tax liability. The taxpayer is requesting relief from an undisputed tax liability based on an inability to pay. California Revenue and Taxation Code section 19443 authorizes the Franchise Tax Board to enter into compromise agreements with taxpayers regarding final tax liabilities. The term "tax liabilities" includes interest, penalties, and other additions to tax.

**Audit Guidelines and Impact on Audit Determinations**

For settlements approved after January 1, 2003, the settlement agreements will address how a specific settlement adjustment will be treated in subsequent years or if an adjustment will affect any other pending audits. For settlements approved prior to January 1, 2003, the closing agreement will address other items effecting other years or secondary audits.

If the agreements do not address how the settlement adjustments will effect other years, the settlement adjustments are disregarded for subsequent years. If an agreement is final and a secondary examination for the same year is not addressed, any other adjustments may be barred from an assessment. An exception is provided upon showing of fraud or misrepresentation with respect to a material fact.

In accordance with the new policy statement dated July 17, 2003, the settlement staff will create an issue folder in the Audit workpapers of the PASS case titled "Settlement Memo" that will contain a memorandum informing the audit staff of the actions affecting the settlement years or subsequent years. In addition, the audit staff may assist settlement staff by disclosing information in the initial audit narrative of any anticipated secondary audits.

At times, auditors may not be able to open the case file because the taxpayer is in settlement negotiations. Under the circumstances, the auditor will need to contact the settlement officer (or responsible owner). Below are guidelines with respect to the impact on subsequent audits and secondary audits.

- Unity determinations are based on the strengths and facts of a current year cycle and not on a prior settlement determination.
- Agreed adjustments effecting carryover adjustments are only considered if addressed in the settlement agreement. For example, suppose the audit schedules were revised by the protest hearing officer and the settlement officer. However, the final settlement agreement *does not*

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address the effect of the Alternative Minimum Tax on the Tax credit for the subsequent year. The auditor for the subsequent year examination would use the Alternative Minimum Tax Credit based on the Alternative Minimum Tax determined by the hearing officer.

- The Internal Revenue Service completes their examination and issues a final federal audit report after the settlement agreement is approved, on June 30, 2003. The settlement agreement does not specify that the revised apportionment formula is to apply to the federal audit adjustment. The auditor is required to use the apportionment percentage from the last determination to compute the additional tax on the federal audit adjustment.
- A secondary examination was completed after a settlement agreement was approved for the same year. The settlement agreement was approved on August 2003. The settlement agreement does not address the second audit. The assessment may not be issued because the settlement agreement bars any additional assessments with the exception of fraud or material misrepresentation.
- The auditor did not disclose information in the audit narrative of an anticipated secondary examination and discovers a pending settlement. The auditor should immediately contact the settlement officer.

**Due to the legal and binding nature of closing agreements, they are drafted by Legal Program staff and reviewed by the Legal Affairs Bureau. The final agreement is generally signed by FTB's Executive Officer.**

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## 3090 TRUCK AUDITS FOR DESK UNIT

MSA Desk auditors scope returns from trucks obtained from DSS. Trucks received by the Multistate Audit Group contain qualified corporate taxpayer folders that contain corporate returns and correspondence. These corporate folders are sorted by California corporation number.

All qualified multistate corporate returns are eventually examined during this process. The most effective method of scoping returns is by examining multiple years at the same time. As a result, returns are examined on a two-year audit cycle. As discussed in **MAPM 3010**, returns within the two-year cycle are the primary focus of the examination; however, all open years may be examined.

The specific tasks associated with this workload are as follows:

Audit trucks are scoped as a team. Selection of the trucks is on a first-in, first-out basis. The team leader records in the truck control logbook the first and last corporate folder on each truck. Each corporate folder on the truck is reviewed to determine if the return merits an audit, should be surveyed without further consideration, or referred to a field office.

Returns that are accepted without further consideration are "surveyed" and identified as such by marking "S/auditor's initials" on the upper right side of the front page of the tax return.

A pink “Recharge Notification slip” must be placed on the truck to identify corporate folders that have been removed.

When the truck is completed, the team leader should put all of the recharges in a messenger service envelope, which should be placed on top of the truck. A route slip to DSS should also be placed on top of the truck. The truck should then be placed in the designated area for completed truck audits and returned to files. Statistics (returns surveyed, field referrals, letters written, and notices issued) are provided to the audit supervisor at the end of each month.

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## 3120 HOW TO REQUEST TAX RETURNS

Obtaining tax returns for examination is a critical factor in the successful operations of the MSA Program. There are four ways to request returns from Data Services and Storage Section (DSS):

- PASS Requests
- Paper Requests
- BETS Requests
- Rush Telephone Requests

Each of these methods will be discussed after a few DSS procedural reminders.

PROCEDURAL REMINDERS that will help expedite return/document request processing:

The preferred method for requesting returns is to generate an in-lieu through PASS. * * *

* * * *

- Legal cases
- Sensitive case
- Misapplied money
- Claims
- Irate taxpayer
- Short statute of limitations

Tax returns requested by Phone requests are usually sent to the auditor within two to four days.

USING OUTLOOK TO SEARCH FOR RETURNS OR AUDIT FILES

Audit staff may use outlook email to request assistance in locating tax returns(s) or audit files if DSS cannot locate the requested information within the time periods prescribed under GPM section 0630 * * * * * * * * * * * * * * * However, the audit staff should **limit** their search to areas where there is a reasonable probability for finding the tax return(s) or audit file. In no circumstances should the auditor send an email to "All Audit Users" because of the potential risk of an unauthorized disclosure.

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## 3130 LIMITED RETENTION DATE (LIM) DATES

A "LIM" date is the date, beyond normal destruction, that the tax return is to be maintained in Data Services. The requester determines the LIM date of a return according to individual needs of each case.

Determine the year to which the return should be saved and write that year in green felt pen, not a green pencil, in the upper left-hand corner of the return. For example, you have an RAR in 1998 where you know that the case is in Tax Court and the taxpayer has stated it will take several years for the case to be resolved. The auditor determines that the return should be preserved until the year 2009. Consequently, you would write "LIM 09 RAR" in the upper left-hand corner of the return. This means the return will be kept until 2009 and was "LIMMED" for RAR.

Other LIM codes are:
MC - Major case
C/A - Corp audit
C/O - Collections
CL - Claims
NPA - Notice of Proposed Assessment
L - Legal

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## 3140 RETURNS RECEIVED FROM THE TAXPAYER IN THE FIELD

Whenever a return (delinquent or amended) is received from the taxpayer in the field, with or without remittance, and is required for audit, compliance or other purposes, a photocopy of the return will be made and the original will be forwarded to central office for numbering and processing.

Any action to be taken on the return should be made using the photocopy of the return filed. When submitting the completed report for review, the box entitled "Taxpayer's Copy" should be checked on the form FTB 6430. "Taxpayer's Copy" should also be written in "red" on the photocopy of the return.

If at a later date it is decided that the original return is needed in order to complete the audit, it should be requested from Data Services.

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# 4000 AUDIT WORK IN PROGRESS (WIP)

MAPM 4010 Audit Workpaper Preparation
MAPM 4020 Workpaper Preparation Standards
MAPM 4030 Uniform Format
MAPM 4035 Index to Audit File, form FTB 6869a
MAPM 4040 Audit Program Worksheet, form FTB 6833
MAPM 4050 Event Log
MAPM 4060 Audit Issue Section, form FTB 6870B (Pass)
MAPM 4065 Audit Issue Section – Verification, form FTB 9910
MAPM 4070 Audit Plan

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## 4010 AUDIT WORKPAPER PREPARATION

Workpapers are prepared as a record of the auditor's work. This record is necessary to support and, if needed, defend the audit recommendation. A uniform method of accumulating and presenting this record has been developed for use in all department tax audits. The design of this format is intended to achieve the following objectives:

- To require that auditors maintain an accurate, thorough, and usable record not only of the information developed during the audit but also of the procedures used to obtain and evaluate this information. This record of both what has been done and what has been found is necessary in order to support the auditor's recommendation.
- To provide a method of presentation that will make the information contained in the file easily retrievable.
- To ensure the flexibility necessary for use in all cases. Each audit is unique, and the procedures and techniques necessary to successfully complete a given audit will depend on the situation. The uniform workpaper format adapts well to any audit. It avoids the possible confusion of a standard workpaper format with a standard audit program (which cannot be developed for our purposes because each assignment is different), and emphasizes the need for the auditor to determine what is to be done on each case.

The volume of workpapers will vary from case to case. A general guideline is to include all relevant data and material that are prepared or obtained during the examination. This will involve several distinct kinds of documents both electronic (PASS) and paper, including:

- An Index to Audit File
- Audit Program Worksheet
- Audit Issue Sections (including verification)
- Event Log
- Correspondence
- Information Document Requests (IDRs)
- Audit Issue Presentation Sheets (AIPS)
- Notes or other narrative material prepared by the auditor
- Copies of documents obtained from the taxpayer or third parties
- Other data as needed
- PASS and Non-PASS Audit Schedules (See PASS tips folder to copy non-PASS schedules into a PASS workpaper folder.)

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## 4020 WORKPAPER PREPARATION STANDARDS

Auditors have considerable latitude in preparing workpapers, as long as the following standards are met:

- Neatness and legibility are of utmost importance
- Number all pages for cross-referencing purposes
- Include the auditor's initials and date prepared on all pages.
- Label each workpaper with an appropriate heading such as:

**TAXPAYER NAME**
**TAXPAYER ID NUMBER**
**ISSUE**
**YEARS INVOLVED**

PASS gives auditors the ability to create headers and footers on WORD or EXCEL templates contained in the system. Many of these templates are programmed with auto-population features allowing the system to automatically create headers and footers. Information included in these headers and footers generally consists of case unit name and number as well as folder where located, document name and page number. Auditors may revise the header and footer information to agree with their cross-referencing scheme.

All workpapers must be numbered, indexed and cross-referenced. Logical subdivisions must be established so that workpapers are grouped by topic or issue. Subdivisions must be summarized and indexed on the Audit Program Worksheet. Numbers should be shown at the bottom-center of each workpaper and include both the section and page (1/1, 1/2, 2/1, 2/2, etc.).

Notations must be included to identify the source of all data included. Documents must indicate when and from whom they were received. The name of the person who furnished the information must be noted. If necessary for identification, note their position. In large audits you may receive information from numerous people. Comments like "received from taxpayer" are not precise.

If not self-evident, the significance of each workpaper should be briefly noted. Notations must be made to explain each symbol (tick-mark, triangle, etc.) that was used for indicating the verification of amounts or totals. This applies to copies of taxpayer documents included as audit workpapers.

**CAUTION:** Copies of workpapers and other documents may be requested by the taxpayers or their representatives. Workpapers, narratives and other documentation should reflect an objective, unbiased audit.

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## 4030 UNIFORM FORMAT

The uniform format for all tax audits requires use of the following items on PASS:

Event Log

Form FTB 6869a, INDEX TO AUDIT FILE

Form FTB 6833, AUDIT PROGRAM WORKSHEET

Form FTB 6870B, AUDIT ISSUE SECTION

Form FTB 9910, AUDIT ISSUE SECTION – VERIFICATION

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## 4035 INDEX TO AUDIT FILE, FORM FTB 6869A

The purpose of form FTB 6869a, Index to Audit File, is to facilitate cross-referencing between the PASS electronic file and associated paper files of an audit package. PASS static folders are listed on the form. The form gives the auditor the flexibility of adding folders to reflect issue folders created in PASS. The form contains two columns for cross-referencing purposes: (1) PASS File Name, (2) Physical Document File. Enter the appropriate cross-referencing value in each column. At the completion of all audit work, print the index form and attach it in front of the workpapers in the paper file.

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## 4040 AUDIT PROGRAM WORKSHEET, FORM FTB 6833

The Audit Program Worksheet should be used to identify the possible audit issues and to index the workpaper file. This document is found in the * * * * * * * * * * * * * * * * * * * * * * * * * * *.

Procedures:

- List material audit issues and potential amounts involved.
- Designate corresponding Audit Issue Section (FTB 6870B) number in Workpaper Reference column.
- For each issue listed, specify the conclusion (i.e. adjust or no change) on this Audit Program Worksheet once it has been determined.

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## 4050 EVENT LOG

The Event Log provides users with a detailed listing of all actions taken or recorded in PASS for a specific case unit. It can be viewed at either the case or case unit level. However, entries are made only at case unit level. PASS automatically records some entries in the Event Log while the user must enter others. See PASS Help for details on events recorded by PASS. Users should periodically review the Event Log to ensure the automatic record features are properly functioning and to ensure manual events are recorded.

Print the Event Log only in extremely unusual situations such as a subsequent user of the file not having access to PASS. If printed, attach the log to the workpaper file directly underneath the form FTB 6869a Index to Audit File and ensure it is properly labeled and numbered for cross-referencing purposes.

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## 4060 AUDIT ISSUE SECTION, FORM FTB 6870B

The Audit Issue Section accomplishes the following:

- Divides the workpaper file by topic.
- Provides sub-indexes for each Audit Issue Section.
- Provides a summary and record of the audit process for each Audit Issue Section.

Form FTB 6870B is formatted to provide a record of the audit process (Summary Explanation as Reported and Conclusion) for those audit issues that lend themselves to this format. These segments are completed as the audit progresses, beginning with the pre-field audit activity. Reference to supporting workpapers should be provided within the text of the document. The name of the * * * * * * * * should reflect the issue under audit.

FTB 6871D (Notes) and FTB 9904 (Free Form) are other PASS templates which can be used to summarize and reference groupings of information that do not lend themselves to the "As Reported and Conclusion" format of FTB 6870B. Examples would include the following:

- Background Data
- Planning
- Pre-Audit Information
- Documents that require cross-referencing to more than one program item

For a complete listing of templates available in PASS, refer to PASS Help.

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## 4065 AUDIT ISSUE SECTION – VERIFICATION, FORM FTB 9910

The purpose of form FTB 9910 Audit Issue Section – Verification is to provide auditors with a means of documenting audit activity on specific audit issues. Documenting our activity serves as the central basis for supporting audit determinations as cases move through various stages of the audit lifecycle. Form FTB 9910 or the equivalent form FTB 6870B is required on all cases and should be prepared as thoroughly as possible.

Section Headings:

- Summary Explanation of Items Reported – Use this section to explain how the issue was reported (or not reported) on the state return, how it was identified and why the decision was made to pursue (or not to pursue) the issue.
- Verification Procedures – Use this section to document steps taken in identifying, developing and reaching the audit conclusion. Mention all sources relied upon such as annual reports, unitary questionnaire or meeting minutes in support of the audit determination. Also mention any research conducted along with the sources and results of the research.
- Conclusion – Clearly state the results of the examination. Include references to any law sections, regulations, SBE cases or District Court decisions in support of your conclusion. Also mention any policy considerations relied on in supporting the audit conclusion.

Include all workpaper references in the column labeled "W/P REFERENCE." Workpaper references should agree with form FTB 6869 Index to Audit Workpapers.

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## 4070 AUDIT PLAN

### Purpose

The purpose of the audit plan is to establish open lines of communication and to promote understanding of commitments made and agreements reached. The audit plan is a tool that provides a road map of how the audit began, how the audit is progressing, where the audit is going, and identifies key potential audit issues. It allows the auditor and the taxpayer to work together to resolve problems as early as possible in the audit process and establishes a partnership relationship. The audit plan helps ensure an effective and efficient audit that is less burdensome, less costly and less intrusive.

Taxpayer participation in the development of the audit plan is encouraged. The Franchise Tax Board staff should be receptive to the taxpayer's suggestions of "what are we doing well", and "what can we do to make it better?" By involving the taxpayer in the audit plan:

- Both parties will more efficiently manage the fact gathering and analysis process.
- It will allow the taxpayer to anticipate deadlines and provide alternative solutions to resolving issues, such as using alternative documents, and using agreed sampling methods where the records are too voluminous.
- It will alleviate any apprehension the taxpayer may have about what to expect, and foster communication and cooperation in the audit process.
- Issues to be included in the audit plan should be based on the materiality of the potential adjustment and balanced with the statutory requirement to determine the correct amount of tax. If potential for an audit adjustment is likely, the issue should be pursued if the materiality of the potential adjustment warrants the audit resources necessary to audit the issue. Materiality is a facts and circumstances test and you should consider, and discuss, the materiality of issues throughout the audit.
- Emphasize that the audit plan is a guide for the examination. It is subject to revision as progress indicates the need for more, less or different work than originally planned.

### Components of an Audit Plan

a. When Do You Use An Audit Plan?
b. When Is The Audit Plan Developed?
c. Who Develops The Audit Plan?
d. What Should Be In The Audit Plan?
e. Delivery Of The Completed Audit Plan

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## Additional Information

Additional resources available to assist you in the development of the audit plan are listed in Exhibit B. Exhibit C is an example of a Team Audit Plan.

### a. When Do You Use An Audit Plan?

All audits will use some type of audit plan, though the complexity of the audit plan will differ based on circumstances. For certain audits, e.g., single-issue audit cases, the audit plan might be a simple Scope Sheet. A more formalized, detailed, audit plan should be used on:

- Cases which are either large and/or contain sensitive audit issues; or
- At the advice of the audit supervisor; or
- At the request of the taxpayer; or
- As a result of the auditor's judgment.

### b. When Is The Audit Plan Developed?

The audit plan sets forth the road map for the audit and therefore would be completed as a preliminary step. Upon completion of the preliminary audit procedures and scope, the auditor should prepare a draft audit plan.

- The draft audit plan may be sent to the taxpayer with the letter confirming the initial appointment in order to initiate discussions during the opening conference.
- The draft audit plan should be discussed and reviewed with the taxpayer during the opening conference.
- After the opening conference, the lead auditor, the supervisor and assigned team members should finalize the draft audit plan incorporating changes made as a result of discussions with the taxpayer.
- If there are significant changes to the draft audit plan and the supervisor was not present at the opening conference, the lead auditor should submit the audit plan to the supervisor for review and approval before finalizing.

### c. Who Develops The Audit Plan?

In a team audit, the lead auditor should prepare a preliminary draft of the audit plan, with team members providing comments, and submit the plan to the immediate supervisor for review and approval. The supervisor and program manager might also provide input on planning, the role of the team members, involvement of the supervisor and/or industry specialist, or anything vital to management's role and approval. In addition, the input provided by the taxpayer at the opening conference will also be considered.

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### d. What Should Be In The Audit Plan?

The following items are typically included in the audit plan although not necessarily all-inclusive. Additions or deletions from the audit plan should be done on a case-by-case basis.

*Items common to all audit plans include:*

#### 1. Audit Scope

The audit scope shows the years being examined, MSA office conducting examination, results of prior years, how examination began, etc.

#### 2. Purpose Of The Audit Plan

The purpose is to provide a working tool to monitor the progress of the audit, to open lines of communication and establish a partnership relationship with the taxpayer.

#### 3. List of Key Personnel

Key Franchise Tax Board staff and taxpayer personnel, including representatives, should be identified showing their addresses and telephone numbers. If applicable, the role and responsibility of each FTB audit team member should be explained.

It should be confirmed that the taxpayer personnel identified in the audit plan are authorized to provide the Franchise Tax Board with records or enter into preliminary and final discussions with the Franchise Tax Board relative to issues or other items of interest.

#### 4. Timeframes

Establishing timeframes and adhering to them is critical in successfully completing cases on a timely basis. Throughout the audit process, these timeframes serve as benchmarks against which progress can be measured. Timeframes should be established for:

- Estimated starting date and estimated completion date.
- Expected response time frames on IDRs, AIPs and correspondence.
- Schedule of tentative field appointments.
- Status Conferences - to periodically meet and discuss audit issues, emerging problems, how the flow of information is progressing, and the general status of the audit.

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- Waivers - Current statute of limitations and policy for managing the SOL throughout the audit.

**5. Status Of Federal Audits**

The status of any federal audit, if known, should be included in the plan. Periodic follow-ups during the audit may be needed to ascertain the current status of the federal audit.

**6. Amended Returns Filed By The Taxpayer**

It should be ascertained from the taxpayer whether any amended returns have been filed of which the auditor may not be aware. In addition, knowing about any anticipated amended returns that might be filed by the taxpayer is helpful in managing the audit process.

**7. Audit Issues**

Known audit issues and the potential tax effect should be identified and set forth. The taxpayer should be informed additional issues may arise and changes may be made during the course of the audit.

**8. Audit Procedures**

Procedures should be set forth for issuing IDRs, AIPS and the closing letter.

**9. Audit Logistics**

Numerous logistic issues to be discussed with the taxpayer should be included in the plan. These might include:

- Location of the audit records.
- Taxpayer's record retention policy.
- Availability of photo copying equipment and procedures for photocopying.
- Adequate accommodations - audit room, storage of taxpayer's records, telephones, rest rooms, cafeteria facilities, etc.

**10. Amendments To The Audit Plan**

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The audit plan is a guideline for conducting an examination and can be amended throughout the on-going audit process as circumstances warrant. Any amendments to the original audit plan must be acknowledged to the taxpayer in writing and/or be provided in an amended audit plan issued to the taxpayer.

The audit team should be receptive to any suggestions by the taxpayer that would expedite the audit process and/or facilitate the taxpayer's task of complying with the audit team's information requests, without the loss of audit quality.

**e. Delivery Of The Completed Audit Plan**

The audit plan should be signed and dated by a senior member of the taxpayer's staff, preferably an officer, the senior tax manager or the representative. The auditor should document the delivery of the plan in the PASS file.

The audit plan should be signed and dated by the auditor and the audit supervisor. In some cases, it may also be appropriate to get Program Manager approval.

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## 5000 WORKING WITH TAXPAYERS

MAPM 5010 Working With Taxpayers
MAPM 5015 Opening Conference
MAPM 5020 Correspondence
MAPM 5030 Information Document Requests
MAPM 5050 Follow-Up & Keeping The Audit Current
MAPM 5060 Taxpayer Fails To Respond To An Audit
MAPM 5065 Audit Issue Presentation Sheets (AIPS)
MAPM 5070 Concluding The Audit With The Taxpayer
MAPM 5080 Position Letter
MAPM 5090 Closing Conference

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## 5010 WORKING WITH TAXPAYERS

Establishing a positive working relationship with the taxpayer that is conducive to the effective and timely completion of the audit is critical in every audit assignment.

During the course of interaction with the taxpayer, considerable effort should be directed toward ensuring that:

- The purpose of the audit and the legitimate need for information requested are conveyed to, and understood by, the taxpayer.
- The evaluation of audit data and the resulting determination of tax liability are made in a fair and impartial manner.
- The audit progresses with a minimum of inconvenience to the taxpayer.
- The final audit recommendations are supported by both the facts and the law and are discussed with, and understood by, the taxpayer.
- Audit Issue Presentations Sheets (AIPS) should be issued to the taxpayer as soon as the auditor has completed the issue, rather than waiting until the end of the audit to explain the adjustment. (See **MAPM 5065** for discussion of AIPS.) AIPS should be used for all material adjusted issues.
- The auditor should always communicate the results of the audit in writing to the taxpayer, and provide the taxpayer with the opportunity to rebut any findings. Where appropriate, or when requested by the taxpayer, a closing conference may be conducted and the supervisor may attend.

The following are suggestions on receiving cooperation from taxpayers and tax representatives:

- Auditors should conduct themselves in a courteous and professional manner. Your tone in letters and on the telephone is very important. As the auditor, you want to be treated politely and with respect and so does the tax representative and taxpayer. Words such as "thank you", "sincerely", "your cooperation is appreciated", "look forward to your response", "you are correct with respect to...” "although I understand your argument...", and "if you have questions, please call..." convey this feeling.
- When the taxpayer is verbally abusive and uncooperative, be cooperative and professional. If you respond with an equally abrasive attitude, you will not gain cooperation. If you are cooperative, it is difficult for taxpayers to remain uncooperative.
- Timeliness in your audit sets the tone for all follow-ups in the audit, and your ability to effectively close the audit. For example, if you take six months to reply to the taxpayer, the taxpayer will not give your next request for information a high priority. You should set a comparable response timeframe (same as we require from taxpayers) and stick to it. Although we typically respond to taxpayers within 30 days, try replying within 10 days to two

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weeks. This shows the taxpayer that the case is a high priority to you, and the taxpayer will also respond timely.

- Always set the taxpayer's response date to a specific due date (e.g. June 15, 2002) to reply. A specific due date avoids the confusion that setting the response date at 30 days can cause (e.g. calendar days vs. workdays).

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## 5015 OPENING CONFERENCE

### Purpose

The purpose of the opening conference is to establish the groundwork necessary to conduct an effective and efficient audit. The opening conference establishes lines of communication and helps build a partnership between the auditor and taxpayer. During the opening conference you will introduce the participants of the audit; agree on a general audit plan; discuss audit processes and procedures; agree upon expected timeframes; and start developing a rapport with the individuals that will be working on the audit.

### Components of the Opening Conference

a. Introduction of Personnel
b. General Discussion
c. Audit Plan
d. Discussion of Major Audit Issues
e. Tax Return Preparation
f. Status of IRS Audits and Audits by Other States
g. Company Records
h. Information Document Requests
i. Audit Issue Presentation Sheets (AIPS)
j. Status Conferences
k. Waivers
l. Scheduling Future Audit Appointments
m. Photocopying
n. General Items (office space, etc.)
o. Position Letter/Closing Conference

### Additional Information

Additional resource material that will help you in planning and conducting your Opening Conference can be found in Exhibit A.

### a. Introduction of Personnel

- It is important that personnel be introduced and both parties understand the other's organizational structure. Items that assist in accomplishing this include:

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- The taxpayer should be provided the names and telephone numbers of the audit supervisor, program manager, MSA Field Operations Manager and Bureau Director. The auditor should explain the reporting lines.

- Organization and understanding of the tax department.
  - Knowing the organization of the tax department helps you understand the reporting lines within the taxpayer's corporate structure. If possible, obtain an organization chart showing reporting lines through the Vice President of Taxes or similar position along with phone numbers.
  - It is also helpful to understand the employment history of those assigned to work on the audit. Employees that have prepared the return as opposed to joining the company after returns have been filed may be more familiar with filing positions taken and location of records.

**b. General Discussion**

The general discussion should be relaxed and informal. The purpose of the general discussion is to open communication and to begin forming a professional relationship with the taxpayer's staff. This is an opportunity to:

- Provide a copy of the Statement of Principles of Tax Administration if it was not already provided with the contact letter.
- Provide the taxpayer with a copy of the audit regulation or refer them to it for more detailed information about the conduct of the audit.
- Emphasize our expectation of completing the audit within two years from the initial contact in accordance with the audit regulation. A more detailed discussion of the estimated completion date should be done in conjunction with the audit plan.
- If appropriate, discuss questions you have on the general history of the taxpayer. Are there unusual activities during the audit years? Is the taxpayer undergoing current changes that might impact your audit?
- Determine other "environmental" issues that the auditors should know about such as whether the company is in the process of shutting down their tax department and outsourcing. People are proud of whom they work for and can provide insight into the uniqueness of the taxpayer and what they view as important.

**c. Audit Plan**

(See Audit Plan Section for details)

The purpose of the audit plan is to formalize the groundwork necessary to establish open lines of communication and to promote understanding of commitments made and agreements reached. The

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audit plan is an audit tool that provides a work document, a road map, of how the audit will progress and identifies key potential audit issues.

- The draft audit plan may be sent to the taxpayer with the letter confirming the initial appointment. It should be discussed and reviewed with the taxpayer during the opening conference.

- A major component of the audit plan to be discussed is audit timing. This should include the estimated completion date, timing for IDR responses, follow-up procedures, AIPs response times, etc.

**d. Discussion of Major Audit Issues**

Auditors should inform the taxpayer of the potential audit issues identified during the scoping process. Possible items that might be discussed are:

- Recurring audit issues - Determine the status of recurring issues if the prior audit determination is being protested or was changed during the protest and appeal process. Discuss if there has been a change to the statutory treatment of these items since the last audit. Consider whether the examination of recurring issues can be limited on agreements to facts developed in prior audits. This should be done only when the prior audit development of the issue was comprehensive and after determining what current development is necessary to ensure that the facts in the prior audit are applicable to the current years. If this is feasible, it should be discussed with the taxpayer.

- New audit issues - You might be able to discuss specific issues, for example a sale of an operating division or product line reported as non-business income. However, for other issues, a more general outline can be provided.

- The taxpayer should be informed that additional issues might arise from the review of information in support of the tax return.

- Ask the taxpayer if they have changes or issues that they want to submit for consideration. The earlier that you discover potential claim issues, the easier it is to adhere to your audit timeline.

**e. Tax Return Preparation**

Obtaining information on how the return was prepared will provide valuable information on how to address issues and identify where knowledge might reside within the taxpayer's organization.

- Who prepared the return? If they are not the same people you are dealing with, are they still available for questions or information?
- Was the tax return prepared by the taxpayer or outsourced?

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- What part did the tax department prepare? What part did the divisions prepare?
- What instructions were issued to people who prepared parts of the return? Are the return preparation guidelines available?
- How was apportionment information compiled?
- Where are the tax preparation workpapers located and what lead time is needed to obtain them?
- Are the tax preparation workpapers stored electronically? If so, in what format? Can they be exchanged electronically?
- Have State or Federal amended returns been filed? If so, what is the status of these amended returns?

**f. Status of IRS Audits and Audits by Other States**

- Establish what years the IRS has audited. What is the status? If appropriate, discuss with the taxpayer how they would like to convey any final federal determinations that occur during the course of your audit.

- Determine whether the RAR for the most recent IRS audit has been submitted to the Department.

- Discuss any outstanding controversies at the federal/state level. Do any of the years/issues affect your audit cycle?

- Have any other states audited the years under examination? You may be able to save yourself, and the taxpayer, time and effort by obtaining copies of audit work performed by other UDITPA states.

**g. Company Records**

Company records provide the foundation for factual development. Knowing the following can greatly assist in obtaining needed information:

- What are the taxpayer's recordkeeping practices? What areas of the taxpayer's organization have responsibility for the records you need to examine?

- What electronic records might be available and in what format are they?

- What is the taxpayer's record retention policy?

- What documents have actually been retained? It can be helpful to obtain the document that lists the actual records maintained in storage. Actual documents in storage as opposed to the taxpayer's record retention policy may vary.

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- Generally, how long will it take to retrieve documents from storage?

**h. Information Document Requests**

(See Information Document Request Section for details)

The Information Document Request is an important tool used to obtain the necessary information in a timely manner from the taxpayer. All requests for information will be documented on an IDR. A master IDR Log will be maintained to track all issued IDRs and to provide a clear focus for the status of IDRs. Copies of the Master IDR Log can also be shared with the taxpayer so all parties have a common understanding of the expectations. During the opening conference, the auditor should:

- Discuss the general response timeframes and follow-up process for IDRs. It is important that an understanding be established on the importance of meeting timeframes in order to complete the audit timely. Taxpayers should be informed that it is our practice to issue an IDR, one follow-up, and then, if necessary, a formal demand for the information citing possible application of the failure to furnish information penalty.

- Discuss the general format of the IDR and explain the use of the single question as opposed to single issue IDR. If appropriate, discuss if the taxpayer would like to review the draft IDRs before they are issued.

- Establish who will receive the IDRs and who may be contacted to secure additional records or information.

**i. Audit Issue Presentation Sheets (AIPS)**

(See Audit Issue Presentation Section for details)

The purpose of the AIPS is to communicate the specific audit issue, the facts developed, the relevant law and the audit recommendation on the issue. The issuance of AIPS provides the opportunity to conclude and resolve issues on an ongoing basis. The AIPS is an important tool that keeps the taxpayer fully informed about the audit and the FTB's position on each issue. During the opening conference, the auditor should explain:

What an Audit Issue Presentation sheet contains.

- That AIPS will be issued as soon as issues are completed. Auditors will not wait until the end of the audit to provide this critical information flow.

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- That all adjustments will be explained through the use of the AIPS process.

- Taxpayers are requested to respond to the factual write-up as presented in the AIPS. It is understood and expected that the taxpayer may disagree with the application or conclusion of the law but at a minimum, we should strive to obtain agreement with the factual understanding.

- The timeframes appropriate for responses.

**j. Status Conferences**

(See Status Conference Section for details.)

Status conferences should be held to measure actual progress with planned benchmarks. It is critical that all parties continually monitor the success of the audit. These conferences provide an opportunity to make needed adjustments to keep the audit on track with the planned completion date.

- During the opening conference, the auditor and the taxpayer should develop a plan for when status conferences will be held and what will be expected of each party at the status conferences.

- The status conference should be used to keep the communication process between the taxpayer and the auditor open.

**k. Waivers**

The Audit Regulation sets forth the expectation that the audit will be completed within the normal statute of limitations or two years of initial contact. However, there may be some situations where waivers are appropriate. It is the auditor's responsibility to assure the statute of limitations has not expired. During the opening conference you should:

- Determine if there is a federal waiver and if so, the status.

- Explain how waivers, if necessary, will be handled throughout the audit. See MAPM 9050 through MAPM 9110 for information on handling waivers during the audit.

**l. Scheduling Future Audit Appointments**

Planning the entire audit process through the expected completion date is essential if the audit is to be successfully completed on time. This planning process encompasses anticipated field visits that will be needed to complete the audit. This approach provides a partnership endeavor with the taxpayer so both parties understand the expectations and resources that will be needed to complete the task.

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- Audit examinations are generally expected to be completed within the normal statute of limitations and within two years of audit contact. Therefore, the first contact should occur within two years of filing of the original tax return.

- In order to keep the time frame for completion of the audit within the agreed completion date, the auditor needs to establish future audit appointment dates with the taxpayer. The auditor and the taxpayer should work out a timeline identifying future audit appointments, black out dates, review time, etc. It might be helpful to work backwards from the expected completion date to get a better perspective of the commitments needed in order to meet the 2 years completion date.

**m. Photocopying**

Photocopies of taxpayer records may be needed to support the facts as set forth in the audit report. Only relevant portions needed for the specific issue need to photocopied. It is helpful to:

- Establish what procedures the taxpayer would like for photocopying of records or documents. If the taxpayer requests that its staff does all photocopying; address follow-up procedures if there are any problems.

- In cases where the auditor photocopies documents, if the taxpayer requests, the auditor shall provide a copy of any documents photocopied for the audit file.

**n. General Items (office space, etc.)**

Some taxpayers assign permanent space to auditors until the audit is completed or for the duration of a field visit. If an auditor is provided with an office, the auditor should find out who has access to the office, if keys will be provided and what hours the auditor can enter the office. Taxpayers might be limited in the space that they have available for auditors; however, it is appropriate to request adequate working space in order to work efficiently and protect the taxpayer's records.

- If temporary space is assigned, the auditor might want to request a locking file cabinet to store records or make an agreement with the taxpayer that records will be made available at the beginning of the first day of each field visit.

- For security reasons, many taxpayers require that an auditor obtain and wear an identification or access badge. The badge might provide entry access into the taxpayer's building and certain office areas. Auditors are not authorized to sign any confidentiality agreements in order to obtain an access or identification badge. The auditor should inform the taxpayer that any information provided is confidential and protected by Section 19542. If the taxpayer wishes to take its case to appeal or litigation, it may seek a protective order from the SBE or the courts in order to protect proprietary or otherwise secret information from disclosure to the public. Section 19504 gives FTB

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a right to examine the information without precondition or restriction. Therefore, FTB will not enter into any agreement, which could potentially restrict our ability to use information to which we are entitled.

**o. Position Letter/Closing Conference**

(See Position Letter Section and Closing Conference Section for details.)

During the opening conference, the auditor should discuss both the position letter and closing conference (if planned), so that the taxpayer knows what to expect.

- Position letters can simply make reference to the AIPS that have already been provided to the taxpayer and can also be used to send any remaining AIPS to the taxpayer.

- Complete copies of AIPS already provided to the taxpayer do not need to be duplicated with the position letter unless modified or requested by the taxpayer.

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## 5020 CORRESPONDENCE

Correspondence may be initiated as a result of:

- Scoping returns for potential audit issues.
- Audit inquiries into ownership, unity, business vs. nonbusiness income, etc.
- Claims filed for corporations by amended returns.
- Correspondence received.
- General questions received from corporations, their representatives, or accounting firms.
- Correspondence or returns referred from other sections or units.
- Tax Clearance or Post Dissolution Audits from the Tax Clearance and Post Dissolution Units.

Often, inquiries may be handled by telephone. Auditors are encouraged to use the telephone to answer taxpayers' correspondence and to obtain additional information or clarification. Telephone communication is an efficient and economical alternative when the taxpayer has questions that are relatively simple and will not require multiple contacts. This is true, particularly in the area of Tax Clearance cases, which should be handled quickly due to their high priority status. The * * * * * * * * * * * * * * * * * * * * or the Public Contact Memo form FTB 6622 (PASS) should be completed for each contact.

You must get authorization from your supervisor before calling a taxpayer who is located outside of this country.

### INITIAL CONTACT

The purpose of the audit must be established and communicated to the representative when the initial contact is made. See PASS for a listing of available initial contact templates.

When the auditor sends an initial contact letter or appointment letter, the auditor should enclose the California Franchise Tax Board Statement of Principles of Tax Administration and Mission & Values (form FTB 7899A) and the Notice of Audit (form FTB 1015). Other forms that may be given to the taxpayer are the Frequently Asked Questions About Your Tax Audit (form FTB 1015B) pamphlet, and the California Taxpayers' Bill of Rights (forms FTB 4058 and 4063) pamphlets.

The names and telephone numbers of the auditor's supervisor and manager must be given to the taxpayer early in the audit. The initial contact letter provides a practical means of distributing this information. Other alternatives are:

- List the names and telephone numbers on the letterhead of other early correspondence.
- Add a "cc" section with the information on any early correspondence.
- The information can be included in paragraph form in any early correspondence.

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- The auditor can hand out the supervisor's and manager's business cards.
- The supervisor and/or manager can attend the opening meeting.
- The information can be included on the audit plan.

Any of these are acceptable means of disseminating the information. The auditor is allowed to use discretion in terms of what works best for the particular circumstances of the audit.

For field audit cases, the initial contact is followed up with a letter, confirming the field appointment, the opening conference with the taxpayer's representative, and requesting records to conduct the audit. Single question Information Document Requests (IDRs) can be utilized by enclosing these initial IDRs with this letter, where appropriate.

See the Multistate Audit Technique Manual, **MATM 2710,** for examples of general items to request in the initial information document request.

## CORRESPONDENCE NOT REQUIRING A REPLY

Occasionally, correspondence is received that will not require a written response. These are generally statements of information or comments of the taxpayer that should be filed in the corporate folder. Write "no reply necessary" on the turned-up lower right corner of the document prior to filing. If there is no corporation involved and information is not useful to any other areas of our department, keep the document for a short period of time, (in case of any further contact) then destroy it per departmental guidelines.

AMERICANS WITH DISABILITIES ACT - Requests for alternative formats

If you should receive a request from a taxpayer, or a taxpayer's representative, for an alternative format (e.g., large print, Braille, or videotape) please contact * * * * * * * * * * * * * *.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 5030 INFORMATION DOCUMENT REQUESTS

Purpose

The purpose of an Information Document Request (IDR) is to gather the relevant facts necessary to address the audit issues in a timely and efficient manner. Written requests provide a record of communication between the auditor and the taxpayer and avoid possible misunderstandings that could result from verbal discussions. All requests for information should be documented on an IDR and will use the single question format as the primary vehicle for requesting information. A Master IDR Log will be maintained to track all issued IDRs and to provide a clear focus for the status of IDRs. Copies of the Master IDR Log should also be shared with the taxpayer so all parties have a common understanding of the expectations.

### Components of Information Document Requests

a. Requests for information
b. Time frames
c. Requesting Relevant Information
d. Tracking IDR Status e. Timely Follow-Up
e. Formal Demand For Information
f. Audit Workpaper Requirements and Techniques
g. Draft Correspondence vs. Separate Issue Folders
h. Draft Correspondence vs. Separate Issue Folders

### Additional Information

Additional resources that can assist you with the preparation, followup, and management of IDRs are listed in Exhibit E.

### a. Requests for information

- In most instances, requests for information should be in writing, and should only contain a single question per individual IDR. The IDR should specify the agreed date for the taxpayer to respond.

- The general format of the IDR is the single question as opposed to single issue IDR. This format assists the taxpayer if questions need to be distributed to different departments, provides for better organization in monitoring and following up on IDRs and provides for better organization of the audit workpapers. In the event that an IDR request is unanswered or incomplete, use of the single question format allows the auditor to send a follow-up request using the same IDR but modified to reflect the History Section. Separate IDRs make it easier

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to document the history of a request (i.e., date of the original request, follow-up dates, extensions granted, etc.) in the event a penalty is assessed.

- Verbal requests for documents should be formally incorporated into a written IDR. Verbal requests that are completed while you are at the audit location may all be included in a single, completed-items IDR at the end of the field visit. Any verbal requests that are still outstanding at the end of the field visit should be transferred to single question IDRs and provided to the taxpayer with specific response dates.
- Information document requests should generally be numbered sequentially when they are provided to the taxpayer. They should retain the same number when they are reissued or followed up on (unless the nature of the information request has changed). Auditors may assign numbers differently in order to facilitate team audits, but it is imperative that the taxpayer understands the numbering system.
- If requested by the taxpayer, it is appropriate to discuss drafts of IDRs before they are formally issued.

**b. Time Frames**

- Normally response times to IDRs are a maximum of 30 days from the date of delivery. Requests for extensions of time should be based on the applicable facts and circumstances keeping in mind the benchmarks that must be reached in order to timely complete the audit. Dates to respond to an IDR should be reasonable, but it should be understood that responses must be timely in order to complete the case within the two-year expectation set forth in the Audit Regulation.
- The auditor should work with the taxpayer to arrive at a mutually agreeable date when a response is expected. Auditors are expected to adhere to comparable timeframes for reviewing taxpayer responses.
- 30-day contact - Reg. 19032(b)(5)(C)(1) provides that as a general rule the auditor should contact the taxpayer within 30 days of receiving a response to an IDR. At that time, the auditor should (1) issue additional IDRs; (2) issue an AIPS or position letter; or (3) notify the taxpayer that additional time is needed and provide them with a date for future contact. This is consistent with past audit practice. All taxpayer contact must be recorded in the Event Log.
- Telephone Contact - All telephone contact with taxpayers regarding extensions of IDR due dates, scheduling of field visits, or other matters affecting the progress of the audit, must be followed-up with a brief letter summarizing the auditor's discussion.

  If the taxpayer requests an extended due date for an IDR via the telephone, the granting of the request should be treated as the second request for information. Granting of the extension will

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be communicated to the taxpayer through the issuance of a follow-up IDR with the History section reflecting the extension granted. If information is not provided by the extension date, the next step in the process is the issuance of the Formal Demand.

- Reg. 19032(a)(6) states that the timeframes in the regulations are intended to provide an orderly audit process and cannot be used to limit the taxpayer's right to provide information. This does not mean that the taxpayer has an unlimited amount of time to provide requested information. However, if the taxpayer does provide information while the audit is still open, even if it is after the time period set in the IDRs, the information must be analyzed and applied to the audit findings.

### c. Requesting Relevant Information

- Request for information must be explained to the taxpayer in terms of legitimate audit need. Discussion of the applicable laws, regulations, and department policies is also essential. Requests for information should always be discussed with the representative to find out exactly what corporate records will best satisfy audit verification objectives.
- When issuing IDRs, discuss the content with the taxpayer. Make sure that the taxpayer understands what is being requested, and discuss whether the information being requested will resolve the issue or whether alternative information should be provided. This may eliminate the need for additional IDRs on the same subject.

### d. Tracking IDR Status

- All cases will contain a Master IDR Log which, at a minimum, identifies each IDR number, date issued, subject matter of information requested, expected response date from the taxpayer, actual response date and any applicable comments. In addition, re-issued IDRs will also be recorded in the Master IDR Log.
- The Master IDR Log is the focus document that provides all interested parties an immediate assessment of the status of all issued IDRs.

### e. Timely Follow-Up

- The Audit Regulations require the initial IDR and one follow-up before the issuance of the Formal Demand. If cases are to be completed within established timeframes, seldom will it be beneficial or efficient to exceed this expectation.
- Tracking the status of IDRs is the responsibility of the Lead Auditor. Timely follow-up of unsatisfactory responses should be made according to the timeframe agreed with the taxpayer and included in the Audit Plan.

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- On the re-issuance of an IDR due to an incomplete response or no response, a History Section should be included on the bottom of the IDR. This section should indicate the original issue date, follow-up dates and other applicable information. At a glance, all parties should be able to understand the "track record" of the IDR and its status.
- If the requested information is not provided by the agreed date, the auditor should follow up by re-issuing the IDR with the History Section added. The follow-up IDR may be attached to PASS cover letter Forms FTB 1512 or 1522, if desired.

### f. Formal Demand For Information

- When a taxpayer fails or refuses to furnish information in a timely fashion, a Formal Demand may be required. Audit Regulation §19032 provides for the issuance of the Formal Demand after the second IDR follow-up request for information. This is appropriate when a response to a request for information is unreasonably delayed, incomplete, refused or ignored. The auditor is expected to convey the consequences, in writing, to the taxpayer. The History Section on the IDR provides a written record of the attempts to obtain the information.
- Penalties for Failure to Furnish Information will be assessed if there is a reasonable need for the information requested given the relevant circumstances of the audit.
- PASS Forms 1512 and 4973 may be used as the formal notification process and modified to meet the specific case needs.
- See MAPM 8040 and 8050 for a full discussion of the steps necessary to assess the failure to furnish information penalty.

### g. Audit Workpaper Requirements and Techniques

- The use of the "tickler" feature in PASS is a valuable tool. See PASS Help for additional information on how to use this effective method for reminders on needed follow-ups.
- For team audits, auditors will need to coordinate methods of generating IDRs, numbering and logging IDRs and presenting the history on unanswered IDRs.

### h. Draft Correspondence vs. Separate Issue Folders

To provide for efficiency and effectiveness in issuing IDRs, auditors are given the option of using Draft Correspondence or a separate issue folder to prepare IDRs.

- If IDRs are issued from a separate issue folder, a separate issue folder called "IDRs and IDR Master Log" will be maintained. This folder will contain the Master IDR Log and a separate electronic copy of each issued IDR and follow-up. In addition, a hard copy will be maintained of

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each issued IDR. This method also allows the supervisor or Lead Auditor an opportunity to review and approve the IDR before it is finalized and issued to the taxpayer. This method may be preferable on a large case because it provides the ability to segregate IDRs from all other correspondence and thereby keep the files more manageable.

- If IDRs are issued from the Draft Correspondence file, a separate issue folder called "Master IDR Log" will be maintained that contains the Master IDR Log. Copies of the IDRs will, of course, be in the Sent Correspondence after issuance and hard copies are not required.
- Some auditors also keep a copy of the pertinent IDRs in the appropriate program item sections. Some have noted that this step may add additional time to complete the audit. We must bear in mind that others, such as reviewers, hearing officers and attorneys, will be using the audit file. The additional time may be more than offset by a better-organized file for these users.

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## 5050 FOLLOW-UP & KEEPING THE AUDIT CURRENT

When the requested information is not readily available, the auditor and representative should discuss a response timeframe. The auditor and representative should agree upon a specific date, generally within 30 days, but this should be determined on a case-by-case basis, as long as the audit is progressing to the scheduled completion date. Should the information not be provided by that date, the auditor should promptly follow up on the request. It is the auditor's responsibility to keep the audit process going and to prevent unnecessary delays requested by the representative. As a general rule, field audit activity is not delayed as a result of any of the following pending actions:

1. Court decisions on prior years,

2. Board of Equalization decisions on prior years,

3. Protest decisions on prior years,

4. IRS examinations of prior or current years,

5. IRS appeals.

If a representative cites one of the above reasons for delaying the audit, the auditor should explain that we do not delay audits for that reason. If the representative refuses to cooperate in commencing or continuing the audit, the auditor should consider the use of a formal demand for information, FTB 1513 (PASS). See **MAPM 8040** for a discussion of the penalty for failure to furnish information.

Failure to follow up on deadlines sends a message to the taxpayer that the auditor is not serious about the request and will possibly accept less than what was requested. It also establishes an unacceptable pattern that could impact the auditor's credibility and ultimate recommendations.

The auditor should keep the supervisor and/or lead auditor aware of the status of the audit when continual follow-ups are necessary. A verbal follow-up to the taxpayer, with written confirmation (letter or FAX), of the discussion is usually the most effective method for obtaining information and providing documentation for the audit file.

### PASS TICKLERS

There are two types of ticklers: Notification Ticklers and Document Ticklers. Both types can be set for following up on correspondence * * *

* * * *

- Review outstanding IDRs and new requests. This can be accomplished by providing the taxpayer with a copy of the Master IDR Log.
- Time frames for IDRs should be reviewed for outstanding and new IDRs. If problems are occurring on meeting the time frames, solicit the taxpayer's cooperation in coming to a resolution of the problem.
- Materiality - Any questions the taxpayer has regarding the materiality of an issue that is the subject of an IDR should be addressed.
- Follow-up requests on outstanding IDRs need to be communicated, with specific time frames for completion. The taxpayer should understand that non-compliance could lead to a failure to furnish penalty and a request for subpoenas.
- Any verbal discussion with taxpayer should be followed-up by a written confirmation of what was agreed to during the meeting.

### c. Audit Issue Presentation Sheets (AIPS)

A review of outstanding and new AIPS can be accomplished by providing the taxpayer with a copy of the Master AIPS Log. Other aspects that can be addressed include:

- Discussing and trying to reach agreement on the facts related to the audit issue or describe what facts are still not agreed to, even if there is disagreement as to the application of the law.
- Discussing follow-up requests on outstanding AIPS, with specific expectations for completion. The auditor should inform the taxpayer of the benefits of providing their position to any proposed adjustments. Taxpayer-provided comments should be incorporated into a revised AIPS, if appropriate.
- Providing follow-up written confirmation of any agreements or understandings that resulted from the meeting.

### d. Scheduling of Audit Appointments

Review any dates that were previously established and make any additions, deletions, or adjustments to keep the audit moving towards completion. If an appointment is needed at a location other than the corporate office of the taxpayer, the scheduling of such appointment should be directed through the taxpayer.

### e. Resolution of Disputes Related to the Conduct of the Audit

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Any disputes concerning the conduct of the audit should be addressed with the taxpayer immediately. If the dispute is not resolved between the auditor and the first line taxpayer representative, assistance at the next level should be requested. If the audit supervisor or next level manager of the taxpayer identified in the audit plan is unable to resolve the issue, the taxpayer has the alternative to request Program Manager or Bureau Director assistance to resolve the case. The auditor is also not limited in going to the taxpayer's next level or above to resolve any disputes. All avenues of resolution should be explored in order to maintain the quality and integrity of the audit process.

### f. Need for Authorization for Single Billing

If the taxpayer has filed on a separate return basis or failed to include various subsidiaries in a unitary combined return, and it appears that the audit will be recommending combination of such subsidiaries, you should discuss with the taxpayer the need to obtain a signed Authorization for Single Billing.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 5060 TAXPAYER FAILS TO RESPOND TO AN AUDIT

Auditors should first follow the formal demand for information procedures to obtain the audit information.
Also see **MAPM 8040** for the Failure to Furnish/File after Demand penalty.

## ADMINISTRATIVE SUBPOENAS

An administrative subpoena may be necessary in some cases where the representative refuses to cooperate in furnishing information. A subpoena should be considered for significant issues where failure to furnish information is an issue. The designated program specialist in Technical Resource Section should be consulted by the supervisor or manager for guidance in these cases.

Audit staff should also identify cases where legal support may be necessary to determine and conduct any, necessary depositions to preserve testimony and/or discover such as subpoenas duces tecum, to preserve documentary evidence.

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## 5065 AUDIT ISSUE PRESENTATION SHEETS (AIPS)

### Purpose

The purpose of the Audit Issue Presentation Sheet (AIPS) is to communicate to the taxpayer and all other users the specific audit issue, the facts developed, the relevant law and the audit recommendation on the issue. The issuance of AIPS provides the opportunity to conclude and resolve issues on an ongoing basis. The AIPS is an important tool that keeps the taxpayer fully informed about the FTB's position on each issue. All audit adjustments should consistently be set forth in an AIPS format.

A Master AIPS Log will be maintained to track all AIPS and to provide a clear focus for all adjustments made. Copies of the Master AIPS Log may also be shared with the taxpayer.

### Components of Audit Issue Presentation Sheets

a. Draft correspondence vs. Separate Issue Folder - AIPS
b. Tracking AIPS
c. Numbering the Audit Issue Presentation Sheets
d. Preparing the Audit Issue Presentation Sheet
e. Taxpayer Response to AIPS
f. Revising Audit Issue Presentation Sheets
g. Withdrawing Audit Issue Presentation Sheets
h. Issuing AIPS on No-change Issues
i. AIPS and the Principle Audit Schedules
j. AIPS and the Position Letter
k. AIPS and the Audit Narrative

Additional Information

Additional resources to assist you in preparing and managing AIPS are listed in Exhibit F.

### a. Draft correspondence vs. Separate Issue Folder - AIPS

To provide for efficiency and effectiveness in issuing AIPS, auditors are given the option of using Draft Correspondence or a separate issue folder when preparing and storing AIPS.

- If AIPS are issued from a separate issue folder, a folder called "AIPS and AIPS Master Log" will be maintained. This folder will contain the Master AIPS Log and a separate electronic copy of each issued AIPS and revisions. In addition, a hard copy will be maintained of each issued AIPS.

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This method allows the supervisor or Lead Auditor an opportunity to review and approve the AIPS before it is finalized and issued to the taxpayer. This method may be preferable on a large case because it provides the ability to segregate AIPS from all other correspondence and thereby keep the electronic file more manageable.

- If AIPS are issued from the Draft Correspondence file, the Master AIPS Log will be maintained in a PASS issue folder called "Master AIPS Log". Copies of issued AIPS will be in the Sent Correspondence Folder.
- Some auditors also keep a copy of the pertinent AIP in the appropriate program item section.

**b. Tracking AIPS**

The PASS Master AIPS Log is maintained to track the status of AIPS and should be used as a reference during status conferences with the taxpayer. The Master AIPS Log is created in PASS within the issue folder "Master AIPS Log" using the PASS Template FTB 9911a. This template may be modified to meet the auditor/case needs.

**c. Numbering the Audit Issue Presentation Sheets**

For ease of reference, AIPS should be numbered sequentially at the time they are issued. Auditors may assign numbers differently in order to facilitate team audits, but it is imperative that the taxpayer understands the numbering system so that they are not looking for "missing AIPS" which have not yet been issued.

For example, if team members will be checking out different pieces of the PASS file, AIPS numbers might be assigned to individual issues early in the case and completed as each issue is finished. If using this technique, all the assigned AIPS numbers should be listed in the AIPS log for recordkeeping purposes, and the Date Issued filled in when they are mailed to taxpayers.

Alternatively, each team member might find it easier to use his or her initials along with sequential numbering (e.g. ABC-1, ABC-2, DEF-1, DEF-2.) This methodology often helps the taxpayer identify which team member to respond to on the particular AIPS.

**d. Preparing the Audit Issue Presentation Sheet**

The PASS AIPS template FTB 1541A should be used when preparing the AIPS and can be modified to meet the specific case needs. Generally, a separate AIPS should be used for each issue with the following sections set forth:

- **Issue** - An introductory paragraph setting forth the issue and how the item was originally reported in the return helps the reader with a broad understanding prior to jumping into a list of facts.

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- **Amount of Proposed Adjustment, Year and Approximate Tax Effect** - The specific amount of the proposed adjustment should be set forth along with the approximate tax effect. Supporting schedules will also be provided for amounts reflected on the AIPS. This adjustment amount will be the source of the number directly transferred to the Principle Audit Schedules at the end of the audit. Since supporting schedules are provided with the AIPS, they need not be duplicated again when the Principle Audit Schedules are provided at the end of the audit.
- **Summary of Facts** - The statement of facts should be limited to information developed without analysis, commentary or conclusion. Workpaper references to documents and sources of statements should be included in the factual write-up and also provided to the taxpayer without redactions.
- **Application of the Law/Authority** - Relevant statutory, administrative and case law should be applied against the stated facts.
- **Conclusion** - Stated conclusions should be based on the relevant law and facts.

"Draft AIPS" can be used to communicate the facts developed on an issue at a specific point of time to the taxpayer with the understanding that the application of the law and conclusions will be forthcoming. For example, the taxpayer could be asked to confirm the accuracy of the listed unitary facts and whether any additional facts need to be considered. Application of the law and the auditor's conclusion would follow any submission of additional facts or corrections.

**e. Taxpayer Response to AIPS**

Upon the issuance of AIPS, the taxpayer will be given an opportunity to clarify facts and provide rebuttal arguments to the legal analysis and conclusions. Taxpayers should be encouraged to respond as this can result in the resolution of the issue at the lowest level and minimize time and costs for both the FTB and the taxpayer. At a minimum, attempts should be made to obtain the taxpayer's position with respect to the facts. On the last page of the AIPS, check-box options are provided for the taxpayer's response. The taxpayer can also respond in a separate letter if preferred. Additional items to consider include:

- The taxpayer is requested to provide agreement or disagreement with the facts, application of the law and the adjustment. The taxpayer should be encouraged to provide a response; however, there is a box on the AIPS that the taxpayer can check indicating that a decision is withheld.
- Advise the taxpayer that agreement to the facts and/or interpretation of law does not preclude protest or other administrative rights (the template also contains this statement).
- Taxpayer's responses need to be addressed either in a revised AIPS, subsequent correspondence, or in the position letter as opposed to simply including them in the audit package.

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Response times will vary depending upon the difficulty of the issue and the amount of discussion between the auditor and the taxpayer in advance of issuing the AIPS. Generally, the Audit Regulations provide for a maximum of 30 days for a response to an AIPS. However, auditors may use discretion and consider complexity in allowing less or more time than 30 days as set forth in Audit Regulation §19032(a)(6)(A).

**f. Revising Audit Issue Presentation Sheets**

Once an AIPS has been issued and the taxpayer has a clear understanding of the proposed adjustment, the taxpayer might provide additional documentation and/or rebut the legal arguments presented in the AIPS. This may necessitate issuing a revised AIPS and providing a copy to the taxpayer for response. A revised AIPS should be issued when:

- Additional material facts are provided.
- A different section of the law is applicable other than the one(s) stated in the original AIPS.
- The adjustment amount is revised due to documentation provided or revised interpretation on the state of the law.

The revised AIPS should use the same numbering as the original AIPS with some indication that it is a later version. (For example, AIPS #14 becomes AIPS #14 (Revised XX/XX/XXXX)). The Master AIPS Log should reflect that a revised AIPS has been issued. Do not delete reference to any original AIPS that have been issued to the taxpayer. There should be a record of all copies that have been provided to the taxpayer.

If the auditor determines that a revised AIPS does not need to be issued in regards to a taxpayer's response, the taxpayer's responses need to be addressed either in subsequent correspondence, or the closing letter as opposed to simply including them in the audit package.

**g. Withdrawing Audit Issue Presentation Sheets**

While every effort is made to make a correct determination before the issuance of an AIPS, there are times when an AIPS will need to be withdrawn. In some cases, the taxpayer might provide additional information after being provided with the AIPS. If the taxpayer fully supports a position, the AIPS should be formally withdrawn. This process can be done by using the original AIPS, adding a section at the beginning of the document that provides a brief explanation of the reason for the withdrawal and providing a copy to the taxpayer. The withdrawn AIPS would also retain the same number as the original AIPS. A copy of the withdrawn AIPS should be provided to the taxpayer. In addition, the Master AIPS Log should be updated to reflect that the AIPS has been withdrawn.

**h. Issuing AIPS on No-change Issues**

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The purpose of the AIPS is to communicate with the taxpayer and other users issues that are being adjusted. In order to maintain a focused file that maximizes benefit to other end-users, AIPS will be limited to communicating only adjusted items. (withdrawn AIPS would, of course, remain part of the AIPS file). However, we should notify the taxpayer of issues for which we have requested information but are not making an adjustment.

**i. AIPS and the Principle Audit Schedules**

The AIPS provide the sole basis for the construction of the Principle Audit Schedules. Therefore, the adjustment amounts in the AIPS should reconcile with the numbers in the Principle Audit Schedules. References within the Principle Audit Schedules only need refer the user to the specific AIPS number.

**j. AIPS and the Position Letter**

At the close of the audit, any new AIPS not previously provided to the taxpayer should be included with the position letter. If the taxpayer requests another complete set of all the issued AIPS, they should be provided. Otherwise, the AIPS provided throughout the audit process are sufficient and reference can be made to them. In addition, a copy of the Master AIPS Log should be given to the taxpayer to assist in confirming the accountability of all AIPS issued.

**k. AIPS and the Audit Narrative**

The AIPS should be attached to the Audit Narrative as Exhibits with the position letter. The Explanation of Adjustments section of the narrative can then be substantially shortened.

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## 5070 CONCLUDING THE AUDIT WITH THE TAXPAYER

Prior to making an audit proposal, the results of the audit should be discussed with the representative. This discussion is in terms of tentative proposals based on the information obtained. If there is disagreement, the basis for positions can be informally discussed and the need for additional information determined. The representative should be given the opportunity to submit all facts in support of their position. This information should be evaluated before an audit proposal is made. The representative should be made aware of all possible audit adjustments prior to submitting the final schedules. The auditor should issue an Audit Issue Presentation Sheet (AIPS) during the audit for each material adjusted issue, as soon as each issue is completed, as opposed to waiting until the end of the audit.

**IMPORTANT:** It is essential that the auditor and representative agree on the facts regarding the audit issues, even if the taxpayer does not agree with the auditor's conclusion or adjustment. See **MAPM 6040**, Narrative Report "Statement of Representative" for a complete explanation of this requirement.

### DISCUSSION OF PROPOSALS

When final schedules are submitted to the representative, the auditor should discuss the proposed adjustments with the representative and, when possible, reach an agreement. An informal conference can be held with the representative and audit supervisor on any dispute that the auditor believes might be resolved without requiring the filing of a formal protest.

In the event the auditor's schedules are changed, either by the supervisor or at the review level, the auditor must notify the representative of the revision and provide revised schedules to the taxpayer. This will reconcile the audit adjustments to the NPA.

A discussion with the representative may prevent the return of the file for additional information after a protest is received. Cases may be returned to the field office to determine the validity of the protest, particularly if there is information that was not obtained or made available during the audit.

If the representative does not agree with the proposed adjustments, the protest procedures should be explained. Ideally, the representative will provide the auditor a position statement identifying the basis for their disagreement. Protests received in the field should be forwarded to Sacramento Office, Protest Control Desk, immediately. The auditor should call the Protest Control Desk to notify them that the protest is being forwarded. (See **MAPM 11000** for more information on protests.) Agreement or disagreement should be noted on the FTB 6430, Audit Report and FTB 6431, Narrative Report.

Prior to writing a position letter, the following steps are recommended:

1. Define the Problem or Issue

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The first step in writing a position letter or answering correspondence is to define the problem or issue. In many instances there is only one problem, even though the taxpayer has raised several questions.

2. Determine the Essential Facts

After the problem has been defined, determine the essential facts that should be given to the inquirer. Be cautious not to include issues that are unrelated to the problem at hand.

3. Organize the Facts

Sort the essential facts into a logical sequence. Usually it is best to get to the heart of the problem in the first paragraph, rather than stating our position or affirming our previous action. In the latter instances, the taxpayer may only skim the rest of the letter and not pay any attention to our explanation.

4. Preparing the Letter

Letters should be concise, clear, tactful, complete, and to the point. Use complete sentences. Abbreviations should not be used unless they are previously identified such as: "California Revenue and Taxation Code (CR&TC)." Also, remember to update the address information in the PASS address book, as well as BETS, when you receive more current information from the taxpayer.

**WRITTEN EXPLANATION OF ADJUSTMENTS/POSITION LETTER**

After the auditor has gathered all the facts, organized the facts in a logical order, researched the law governing the issue, and made a determination, a letter presenting the auditor's findings should be mailed/ issued to the taxpayer (Explanation of Adjustments). In order to avoid redundancy, the auditor may prepare a letter and attach copies of the AIPS as enclosures, when appropriate. The letter should:

- Clearly identify the issue
- Outline all the information reviewed (facts)
- State the governing law
- State the auditor's determination (conclusions) based on the facts and the governing law (analysis)
- Provide schedules showing the computation of the adjustments (see **MAPM 6020**).
- State the audit determination is subject to review
- Allow the taxpayer to rebut, clarify and/or present additional facts

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- Provide the taxpayer with the option to pay the additional tax in order to stop the accrual of interest.

Even if the taxpayer does not agree with the auditor's findings, the auditor should at least try to get the taxpayer to agree on the facts.

The auditor should make a reference to the position letter in the Audit Issue Section in addition to clearly stating the final recommendation for such a case. A copy of the position letter should become a part of the official file for each case.

A closing similar to the one that follows should be used:

> This is your opportunity to provide any additional information that you wish to be considered in regards to the proposed adjustments. If you disagree with these adjustments, provide us with specific reasons why you disagree. Include appropriate substantiation, citation of applicable law and any case authority. Additional information submitted by (the auditor fills in a specific date XX/XX/XX) will be reviewed. We suggest that you do not amend the return(s) under examination, as that will only delay the completion of this audit.
>
> Please reply by (the auditor fills in a specific date XX/XX/XX). To ensure proper handling, please attach a copy of this letter to the front of your reply. Mail your reply to:
>
> Franchise Tax Board
> ATTN: 347:HW:XXX (xxx=auditor's initials)
> PO Box 1468
> Sacramento, CA 95812-1468
>
> If you have any questions or concerns please contact me at the telephone number listed below.

PASS paragraphs contain a similar closing paragraph titled "P25560 – Closing." To insert PASS paragraphs into correspondence, see **PASS Help** for "using PASS paragraphs."

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## 5080 POSITION LETTER

### Purpose

The purpose of the position letter is to notify the taxpayer that the fieldwork on the audit is complete and provide the taxpayer or representative with the results of the audit. The position letter should include all AIPS not previously provided and the Principle Audit Schedules. The position letter should be issued in advance of the closing conference, when possible, in order to give the taxpayer an opportunity to prepare for the closing conference.

### Components of Audit Issue Presentation Sheets

a. Items To Be Addressed In The Position Letter
b. Items To Be Included With The Position Letter
c. Taxpayer Response Time To Position Letter
d. Responses by Taxpayer
e. Position Letter As Exhibit to Narrative

### Additional Information

Additional resources to assist you in preparing the position letter are listed in Exhibit H.

### a. Items To Be Addressed In The Position Letter

The position letter should summarize the Audit Issue Presentation Sheets (AIPS) that have previously been provided to the taxpayer and those that are enclosed in the final report. It should tie the adjustments to the attached Principle Audit Schedules.

It should include an explanation of any adjustments for which no AIPS have been issued, such as adjustments that result from other audit adjustments or Computations. Examples include the alternative minimum tax, limitations on tax credits, and NOL carryover.

If applicable, the position letter should explain any administrative items, such as identification of suspended corporations, explanation of the application of pending payments, proposed actions on outstanding claims, etc. It should also include an offer to the taxpayer to pay the proposed assessments to avoid accruing additional interest on additional tax due.

The position letter should state that the audit is subject to review both by the auditor's supervisor and by Technical Resource Section (TRS). The review might disclose the need for more documentation, or changes to the auditor's recommendations. If the supervisor or reviewer requires changes to the

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auditor's report, the auditor will notify the representative of the revisions. The timeframes for closing the case and issuing any notices should be included.

When the taxpayer and representative disagree with audit's recommendations, the taxpayer and representative should be informed of the protest, appeal, and settlement process in the position letter.

Request for Authorization for Single Billing - If taxpayer has filed on a separate return basis or failed to include various subsidiaries in a unitary combined return, and the audit has recommended combination of such subsidiaries, the taxpayer should be asked to complete and sign an Authorization for Single Billing if a single billing is needed or requested by the taxpayer.

**b. Items To Be Included With The Position Letter**

Documents, schedules, and any other information needed to explain the audit adjustments should be provided to the taxpayer throughout the course of the audit with the AIPS. Various documents and information that provides the taxpayer with a reference for reviewing the final audit schedules or completed case results should be provided to the taxpayer with the position letter. These documents may also assist the taxpayer in making changes to subsequent period returns, with post-audit activities including payment of additional taxes, protest action and preparation for potential, subsequent audits. The following is a list of items that can be provided to the taxpayer with the position letter if not previously provided.

- Principle Audit Schedules and supporting Audit Schedules.
- Tax effect by issue.
- Master AIPS Log.
- Copies of any newly issued AIPS, revised AIPS, and, if requested, previously issued AIPS.
- Copy of any work papers, reconciliations of as-reported amounts to revised amounts, or any other information the taxpayer will need to understand the proposed adjustments

**c. Taxpayer Response Time To Position Letter**

The taxpayer should be provided with a reasonable amount of time to respond to the position letter. Response time may be coordinated with the scheduling of the closing conference, if appropriate. The amount of time will vary with the complexity of the audit and the number of newly issued AIPS included with the position letter. With AIPS issued throughout the audit, the taxpayer should already have had an opportunity to address each issue individually. The auditor should work with the taxpayer to agree on an appropriate amount of time for the taxpayer to respond. The following are general guidelines for response times to a position letter that should be included in the audit plan and discussed during the opening conference:

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The Audit Regulation initially sets a response time at a maximum of thirty (30) days. If a significant number of AIPS are included with the position letter, this timeframe could be extended to include a 30-day response timeframe on the AIPS and an additional 30-day response time for the position letter.

Extensions may be allowed if the taxpayer requires additional time, however, the overall goal is still to complete the case within the prescribed timeframes.
It is important that the case be closed and submitted for TRS review with at least 4 months remaining on the statute of limitations. This may cause a need to shorten the general response time or request a short-term extension of the statute of limitations. If a taxpayer requests an extension to reply to the position letter, the auditor's agreement may be predicated on receiving the signed waiver.

**d. Responses by Taxpayer**

- Written Response Provided - If the taxpayer provides a written response, the auditor should acknowledge receipt of the response in writing and address the points raised in the response.

- Additional Information or Documentation Provided - If additional information or documentation is provided with the response, the auditor should analyze the information to determine if it has an effect on the previously issued AIPS or on any proposed audit adjustments. If it does have an effect, a revised AIPS and audit schedules should be issued. If it does not have an effect, the taxpayer should receive a response indicating that we have considered the information, but that no change is being made to our determination.

- If the taxpayer's response or the additional information or documentation mandate an adjustment to an AIPS or revision to the Principle Audit Schedules, revised AIPS and schedules should be sent to the taxpayer. The individual circumstances will determine whether the taxpayer should then be given additional time to review the revised AIPS and audit schedules.

- Verbal Responses at Closing Conference - If the taxpayer provides a verbal response at the closing conference, the auditor should summarize the response and provide a written copy to the taxpayer for verification.

- No Written Response Received From Taxpayer - If the taxpayer does not provide a written response to the closing letter, the auditor should note in the audit narrative their understanding of the taxpayer's position on each of the audit issues.

**e. Position Letter As Exhibit to Narrative**

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Attaching the closing letter, the taxpayer's position letter and subsequent letters of rebuttal as exhibits to the Audit Narrative may substantially shorten the Audit Narrative. The effectiveness of this technique will depend on the complexity of the case and the number of closing letters and rebuttals.

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## 5090 CLOSING CONFERENCE

### Purpose

A closing conference should be held to discuss any items not already covered in the Status Conferences and to review the final audit results. It should include an explanation of the review process and the process for issuing any applicable notices, and rough timeframes so that the taxpayer has an idea of when they should receive any notices. An explanation of how the taxpayer will be notified of any changes during the review process should also be covered. A closing conference should be held on all large cases, cases where the taxpayer requests one or on any other case where the auditor finds it to be an effective communication tool with the taxpayer.

This is also an excellent opportunity to obtain feedback on what worked well in the audit process and for obtaining suggestions from the taxpayer on things that could be improved.

### Components of the Closing Conference

a. Planning the Closing Conference
b. Agenda for Closing Conference
c. Goals of the Closing Conference
d. Who Should Attend the Closing Conference
e. Documenting the Closing Conference
f. Letter To Taxpayer When Case Is Sent To Technical Resource Services

Additional Information

Additional information regarding for planning and conducting a closing conference are listed in Exhibit G.

### a. Planning the Closing Conference

- **Timing the Conference** - The timing of the closing conference might vary with the type of audit conducted. A meeting can be held with the taxpayer on the last day of the fieldwork, explaining that a closing letter with audit schedules is to be provided. Alternatively, the closing conference might be conducted at a later date after the taxpayer has had time to review the audit closing letter and audit schedules.
- **Position Letter** - A position letter should be issued to advise the taxpayer that the fieldwork on the audit is complete. The position letter should be issued in advance of the closing conference when possible, in order to give the taxpayer an opportunity to prepare for the closing conference.

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- **Audit Issue Presentation Sheets (AIPS)** - Notification of the resolution of audit issues should be made during the course of the audit through the use of AIPS issued at the time the analysis related to each issue has been completed. Copies of the AIPS can be provided as attachments to the closing letter if requested by the taxpayer in preparation for the closing conference. At a minimum, you should plan on discussing any AIPS that the taxpayer has not yet responded to.
- **Preliminary Principle Audit Schedules** - Preliminary Principle Audit Schedules that incorporate all of the proposed audit adjustments should be prepared and sent to the taxpayer for review before the closing conference, if possible. Preliminary audit schedules are subject to changes and corrections.

**b. Agenda for Closing Conference**

The auditor should prepare an agenda for the closing conference with input from the taxpayer and provide copies to each person in attendance. The items below are suggested topics for the closing conference.

- **General explanation of proposed adjustments** - The taxpayer should already have a good understanding of the proposed adjustments as communicated through the AIPS and the closing letter. This conference provides an opportunity to clarify any remaining issues the taxpayer might have. If the taxpayer has not responded to the AIPS, the importance of having at least an agreement or disagreement as to the audit's facts and conclusions should be discussed.
- **Flow of Proposed Adjustments** - The auditor should review the audit schedules to ensure that the taxpayer understands how the adjustments flow through the schedules.
- **Notices** - Explain what the taxpayer can expect in the form of notices. This is a good time to discuss an Authorization for Single Notice if appropriate.
- **Handling new information that the taxpayer wants to provide** - If the taxpayer makes a request to provide additional information or documentation at this time, address how this information will be incorporated into the audit package and how any resulting changes will be handled.
- **Review Process** - Explain the review process by the audit supervisor and by the Technical Resource Section (TRS). Provide estimates of the dates when the audit will be submitted for review to the audit supervisor, forwarded to TRS for review and when issuance of notices can be expected. (The Audit Regulations provide a guideline that any notices should be issued with 90 days of the closing of the case and submission to TRS.)
- **Protest, Appeal, and Settlement** - If not already included in the closing letter, provide an explanation of the taxpayer's protest, appeal, and settlement rights. (See MAPM 6070).
- **Status of Federal Audits** - Update any developments on the status of federal audits and the issuance of any subsequent Revenue Agent Reports.

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- **Subsequent Audit Cycles** - Discuss subsequent audit cycles that might be pending. Inform the taxpayer if you know that another office will be doing the audit. If appropriate, discuss the estimated start date of the next cycle.
- **Other** - Seek input from the taxpayer on the audit process. Discuss what worked well and what improvements could be made. Provide the taxpayer an opportunity to discuss any items he/she might have.

### c. Goals of the Closing Conference

The auditor should be able to determine the following by the end of the closing conference:

- Whether the taxpayer agrees or disagrees with each of the AIPS and Principle Audit Schedules.
- Whether a formal protest will be filed. If so, attempt to obtain, and document, a full understanding of the taxpayer's position or request that the taxpayer provide the position prior to submitting the case for review.
- Whether the taxpayer will need additional time to review the audit findings or audit schedules. Agreement should be reached between audit and the taxpayer as to the amount of additional time the taxpayer needs and has for review. Extensions should be considered consistent with the timing requirements of Audit Regulation 19032.
- Whether a waiver is needed in order to provide the taxpayer with additional time for review. If the taxpayer intends to submit additional information and/or documentation following the closing conference, the auditor should advise the taxpayer that a statute of limitations waiver might be necessary to review any supplemental information.
- That the taxpayer understands what the process will be for communicating any changes made to the audit adjustments during the review process.

### d. Who Should Attend the Closing Conference

- Whenever possible, the audit supervisor should attend with the auditor/audit team. The audit supervisor may want to introduce the lead auditor for the next audit cycle during the closing conference.
- Through the course of the audit, the auditor will have learned the names of the taxpayer's staff that is involved with the audit process. At a minimum, the auditor should request that the person who primarily handled the audit (e.g. tax manager, tax director, CFO) should attend along with his or her direct superior.

### e. Documenting the Closing Conference

A summary of the closing conference should be put in writing for the audit file and a copy should be mailed to the taxpayer.

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### f. Letter To Taxpayer When Case Is Sent To Technical Resource Services

In some cases, it might be appropriate to provide the taxpayer with additional notification about the handling of the case. If it has taken some time to compile the audit case and/or for supervisor review due to workload constraints, you might want to notify the taxpayer when the case leaves the local office.

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# 6000 CLOSING THE AUDIT

MAPM 6010 The Audit Report Package
MAPM 6020 Adjustment Schedules
MAPM 6030 Narrative Report
MAPM 6040 Outline For Narrative Report
MAPM 6050 Walker Letter Situations
MAPM 6060 Notice of Proposed Adjusted Carryover Amount
MAPM 6065 No Change Audits
MAPM 6070 Unagreed Adjustments
MAPM 6080 Jeopardy Assessment
MAPM 6090 Notice Of Action On Jeopardies
MAPM 6100 Payments Received In The Field
MAPM 6110 Payments Received At Central Office
MAPM 6120 Minimum Adjustment
MAPM 6130 Notice Of Revision
MAPM 6140 Post NPA Cases
MAPM 6150 Audit Subject To Review
MAPM 6160 Deferment Of Final Assessment Of NPAs
MAPM 6170 Suspended Corporations

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## 6010 THE AUDIT REPORT PACKAGE

The product of the audit process is the Audit Report Package, which is used to communicate and support the audit recommendation. It includes the following:

- Adjustment Schedules
- Narrative Report, form FTB 6431 (PASS)
- Workpaper File (See **MAPM 4030**)
- Exhibits
- Forms, including:
    - FTB 6430, AUDIT REPORT (See **MAPM 7070**)
    - FTB 6830, NPA WORKSHEET (See **MAPM 7020**)
    - FTB 6638, AUDITOR'S RECOMMENDATION – FORMAL CLAIM (See M**APM 7050**)
    - FTB 6163, ABATEMENT/REFUND MEMO (See **MAPM 7110**)
- Tax Returns

Specific instructions on the preparation of the above are contained in the section specified above, but all circumstances cannot be anticipated. Questions that remain after review and application of available specific instructions can generally be resolved by the auditor and supervisor by following the guideline in the Completed Audit Evaluation, form FTB 6502E that states:

Taken as a whole, do the narrative, exhibits, schedules and workpapers constitute a self-supporting report where a reviewer, attorney or other interested party can readily obtain an accurate and complete picture of what was done on the audit, and if necessary, defend the auditor's proposals without assistance from the auditor?

### COMPLETION OF AUDIT

The auditor must turn in the case into their supervisor with at least 6 months left on the statute and the case must be submitted to Review in Sacramento with at least 4 months left on the statute. (See **MAPM 9000** for statute of limitations information). This is necessary to provide sufficient time for the review process and allow for any possible further contact with the taxpayers if required. If the statute of limitations will expire within 90 days after the file leaves the unit, a form FTB 7011 (RUSH) must be completed and attached to the front of the file when the case is submitted for review. (See **MAPM 7090** for completing form FTB 7011)

If the statute will expire less than four months after the case is submitted to review, circle in red the statute date on form FTB 6430. In addition, the supervisor shall include a note describing the circumstances surrounding the case which resulted in it being submitted within four months of the statute of limitations. The program manager shall approve the submission.

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## CHECK LIST FOR CLOSING CASES ON PASS

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## 6020 ADJUSTMENT SCHEDULES

It is important that staff communicates and support their audit recommendations. Adjustment Schedules should start with the amounts reported on the return followed by the applicable audit adjustments with references to the relevant taxpayer's document and the supporting schedules. The applicable section of the law or regulations may also be referenced. Thorough footnoting, when feasible, and thorough cross-referencing of schedules is important.

All Schedules should include the following information:

- HEADING:
  - Key Corporation's Name
  - Type of Schedule
  - Taxable Years

- Date completed and initials

- Schedule number
- Taxable years indicated in columns

- All copies of schedules, workpapers, and exhibits furnished to the representative must indicate "Copy furnished to (name of representative) on (date)."

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## 6030 NARRATIVE REPORT

The quality of audit workpaper files is critical to our ability to support audit recommendations at the protest, appeals and court levels. The audit adjustments need to be explained in a Narrative Report for those who defend the audit proposals or otherwise use the report. To eliminate redundancy, a copy of the written explanation of adjustments or copies of the Audit Issue Presentation Sheets (AIPS) that are given to the taxpayer can be attached to the narrative.

### PURPOSE OF THE NARRATIVE REPORT

The narrative is a report that explains what the auditor found and the basis of the recommendations. It should do this without the need for additional consultation with the auditor. The workpaper file will provide an understanding of the auditor's methodology and the supporting factual documentation obtained during the audit. It is the workpaper file that provides the basis for the Explanation of Adjustments provided to the representative and serves as the foundation for this report.

It is critical that the facts, the auditor's application of the law, and departmental policies and procedures be clearly communicated to all users. It is important that the auditor and taxpayer/representative agree on the facts of the case. If the facts are not agreed upon at the audit level, the narrative should include an explanation of the disagreement with reference to supporting documents.

The following guidelines are provided for the preparation of this report. A shell for the narrative can be found in the * * * * * * * * * * * * * *. Use judgment in applying these objectives:

### OBJECTIVES:

1. To provide a clear statement of the audit recommendation.
2. To provide a summary of proposed adjustments and their tax effect.
3. To identify areas in which existing department policy may require clarification or modification.
4. To provide any additional information which may be necessary for an understanding of the audit.

### WRITTEN EXPLANATION OF ADJUSTMENTS:

The auditor must provide the taxpayer/representative with a copy of the audit schedules and a written explanation of the basis for the proposed adjustments.

The written explanation must contain a list of the adjustments and, at a minimum, the following information:

1. The factual basis to support each adjustment.

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2. The authority supporting the adjustment.
3. The taxpayer/representative's position on each adjustment.
4. Comment on any unadjusted issues in the current audit cycle that may have an effect on a subsequent audit cycle.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 6040 OUTLINE FOR NARRATIVE REPORT

A narrative report should provide a clear summary of the audit. Following is a guideline. Judgment must be used in determining the detail included. * * *

Indicate if the taxpayer was previously audited and if so, the audit recommendation and the status of those audits (e.g. in protest, appeal, litigation, etc.).

Discuss the nature of the corporation's business both within and without California. Discuss any acquisitions and dispositions.

## AUDIT ADJUSTMENTS

List each audit adjustment and the tax change by year.

| Issue | Years | Amount | Tax Effect | W/P Reference |
|---|---|---|---|---|

## TAXPAYER'S RECORDS EXAMINED (Optional)

List the records examined, noting the taxpayer's document title. Although this is optional for narrative purposes, a detailed and specific reference to the taxpayer's and representative's records used in the audit process must be included in the workpapers.

## EXHIBITS

List documents labeled as exhibits. (NOTE: Closing letters to the representative providing the written explanation of each adjustment, the representative's position letters and subsequent letters of rebuttal should be included as exhibits.)

Provide a description of the significance of each exhibit. Most documents are included with the workpaper file. Large or cumbersome documents, such as Annual Reports, SEC Forms 10-K, or documents prepared by the representative in support of an audit issue, may not lend themselves to inclusion in the workpaper file. These documents should be labeled as Exhibits (A, B, etc.), and referenced or cross-referenced in the appropriate workpaper sections where their significance or evaluation has been recorded.

## METHOD OF FILING

Indicate briefly whether the taxpayer is filing on a totally combined basis (worldwide or water's-edge), partially combined basis or separate basis. If the taxpayer is a water's-edge filer, indicate the start date of the water's-edge contract and whether or not a Notice of Nonrenewal has been filed.

List in an exhibit or in the body of this report, all affiliates in and out of the combined report.

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Describe acquisitions and dispositions of corporations during the years covered by audit.

Refer to the workpaper file or exhibits when citing facts relating to the following areas:

- Organizational structure of subsidiaries and affiliates.
- Ownership (acquired or formed).
- Nature of business of each affiliate.
- Line functions: Common interlocking officers and directors.
- Staff functions: Centralized accounting, legal, purchasing, advertising, personnel, sales and other shared functions.
- Details of all intercompany transactions, including accounts, amounts, percent to total and other relevant information.

## PROPOSED ADJUSTMENTS

Adjustments should be listed by issue and tax change for each year. Reference the Audit Issue Section.

The written explanation of adjustments that was provided to the representative must be attached to this summary as an explanation of the proposed adjustments.

## UNADJUSTED ISSUES

Provide a brief explanation of the unadjusted issues examined. For each item, comment on:

- Issues considered during the audit that were not fully developed.
- Issues developed that resulted in an immaterial or no tax change.
- Future audit issues

## FEDERAL AUDIT ADJUSTMENTS

Indicate date of RAR and date submitted to FTB in cases where the RAR is received in the field. Refer to the applicable Audit Issue Section for state adjustments based on the RAR.

Indicate last Taxable years audited, and status of audit for current taxable years. If an audit is in progress, state the years being audited by the IRS.

## OTHER AREAS THAT MAY WARRANT DISCUSSION

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Other significant areas, or items that may have an impact on the taxpayer, or the adjustments proposed, should be discussed under a separate heading. Examples of these are:

- TAXABILITY, NEXUS
- CLAIMS FOR REFUND
- JEOPARDY ASSESSMENTS
- BANKRUPTCY
- TAX CLEARANCE
- POST-DISSOLUTION AUDIT
- UNDOCKETED PROTEST
- NET INCOME

How was income reported (basis and source)?

What sources were examined to verify income?

What method and sources were used to determine net income as revised by audit?

Reconcile differences between book and state net income. Refer to working papers. It is mandatory to reconcile or explain why income was not reconciled.

What method and sources were used to determine net income as revised by audit?

## STATE ADJUSTMENTS

Examples of state adjustments include:

TAXES MEASURED BY INCOME
SCHEDULE M-1 INTEREST
ADR/ACRS DEPRECIATION
CONTRIBUTIONS
CAPITAL LOSSES
INTERCOMPANY DIVIDENDS
NEW JOB TAX CREDIT
OTHER TAX CREDITS

Identify method of reporting and list source documents examined to verify reported amounts. Explain differences. Indicate how audit adjustments were computed and indicate sources of information.

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**CAUTION:** Material tax credits require audit analysis, and comment in the narrative. The decision not to pursue an audit of a material tax credit must be explained. There are numerous differences between state and federal law.

## BUSINESS AND NONBUSINESS INCOME

Mention items and amounts originally treated as nonbusiness income or loss.

Specify source documents examined to determine treatment of items as business or nonbusiness.

Describe how the items were treated per the audit. Explain the basis for this treatment.

Examples of business and nonbusiness headings are:

**DIVIDENDS**
**INTEREST**
**RENTS**
**ROYALTIES**
**GAINS AND LOSSES ON SALE OF ASSETS**

## APPORTIONMENT FORMULA

### Property Factor

**Total Property:**

Generally, apportionment factors should be reconciled to audited financial statements. Any material differences should be explained.

Source documents need to be examined to verify amounts. Cross-references to related working papers and exhibits must be provided.

Differences must be explained.

An explanation of how the factor was adjusted during the audit must be provided. Indicate any intercompany transactions.

**California Property:**

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Describe the same four items listed under Total Property, above.

**Payroll Factor**

**Total Payroll:**

Describe the same four items listed under Total Property, above.

**California Payroll:**

Describe the same four items listed under Total Property, above.

**Sales Factor**

**Total Sales:**

Describe the same four items listed under Total Property, above.

**California Sales:**

Describe the same four items listed under Total Property, above.

## INTRASTATE APPORTIONMENT

Discuss whether an **Authorization for Single Billing**, form FTB 4523B, is necessary or whether separate billing is required. See **MAPM 7080**.

**Intrastate apportionment** is required in all cases. If it is not performed, the auditor needs to clearly show that intrastate apportionment was not necessary under the circumstances. If the previously assessed tax was not intrastated by the taxpayer, then the auditor must intrastate the previously assessed tax based on the figures as originally filed. (See MATM 7900 for further details.)

The auditor must be familiar with the following sections of the Multistate Audit Technique Manual, MATM 5000, and MATM 7000 - MATM 7900.

## RECOMMENDATIONS

Comment on how notices are to be issued (e.g. form FTB 6830). Explain treatment required in issuing NPAs. For example, "Representative declined to sign a consent for a single billing. Separate notices must be issued."

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If multiple notices are to be issued, be specific.

## STATEMENT OF REPRESENTATIVE

A clear statement of the representative's position to the audit proposals is required. Explain adjustments to which the taxpayer does not agree, why there is disagreement and what support was presented by the representative regarding this issue. The reasons should be explained in sufficient detail so that the protest attorney or the hearing officer will be fully informed of issues and arguments considered during the audit. Whenever possible, the representative's position should be obtained in writing.

**IMPORTANT**: The critical part of the audit is gathering facts. It is essential that the auditor make every effort to reach agreement with the representative on the facts presented at audit. This is **mandatory** in all cases even if the representative does not agree with the application of law or has not provided information.

If the representative has not provided or refuses to provide information to substantiate an issue, this fact must be fully documented in the audit file (correspondence, progress report, audit notes, etc.). The procedures for issuing the "Failure to furnish information" penalty must be followed. See **MAPM 8040**.

## CLOSING SECTION (Optional)

The auditor may also add a statement of the supervisor's comments in addition to the auditor's and supervisor's names and the date.

Auditor's Name Date

Supervisor's Name Date

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 6050 "WALKER LETTER SITUATIONS"

A "Walker" letter is used in situations in which a possible refund exists after the auditor performs preliminary combination tests based on unity. Since one of the department's primary responsibilities is to perform audits on an equitable basis, the "Walker" letter is a vehicle to officially notify the taxpayer that a possible refund exists based on preliminary audit work. The auditor must use judgment in determining whether the refund potential is reasonable. When notifying the taxpayer, it is important to stress that only preliminary audit work has been performed and that it is the taxpayer's responsibility to file a claim for refund and provide documentation necessary to develop the facts.

**REVENUE AGENT'S REPORT (RAR) CONSIDERATIONS**:

In the case of a "Walker" letter situation with an RAR, the RAR should be processed, regardless of the disposition of the case. For example, the RAR should be forwarded to the RAR Unit in Central Office for processing in the following situations:

1. The representative chooses to pursue the refund.
2. The representative chooses not to pursue the refund.
3. The auditor proposes adjustments based upon other significant items besides the method of reporting.
4. The returns are accepted as filed.

**See the following samples of Walker letters. CAUTION: These are examples only. Each case must have a letter designed to cover the situation.**

Example 1

**Date**

**Corporate Name**
**Corporate Address**

**Attention:**

**Taxable Year(s):**

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**Based on preliminary audit work, it appears that the following companies* may be unitary. If they were included as a part of your unitary business for the year(s) shown above, it might result in a change of the corporation's California franchise tax paid for those year(s):**

*** (List companies. If only one or two, name them in the above paragraph. Other wording such as "worldwide combination" or "total combination" or "all subsidiaries" may be used.**

**It appears that extensive work would be required to develop the facts to support a change of these taxes. Due to staff limitations, I am not able to make an exact determination.**

**If the company desires to pursue a possible refund, a claim for refund, with complete supporting detail, should be prepared and submitted to me for each year that is not barred by the statute of limitations. I will review the information and advise you of the result. Additional audit work may be required, and may result in allowing or disallowing the claim, or in proposing additional tax.**

**If I do not receive a statement of the corporation's position within 20 days, I will base my audit on available information and recommend whatever tax change is indicated.**

**If the corporation does not wish to claim a refund resulting from a combined report, the Franchise Tax Board may make adjustments necessary to properly reflect the California income in any future years.**

**CAUTION: This is a model letter only. It should be written to meet the situation in each case. Time allowed for reply should be extended as required.**

**Auditor**
**Telephone number**

Example 2

**Date**

**Corporate Name**
**Corporate Address**

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**Attention:**

**Taxable Year(s):**

**Based on preliminary audit work, it appears that the corporation and its subsidiaries may be unitary. If they were combined (on a worldwide basis) for the year(s) shown above, it might result in a change of their California franchise tax for those years**

**It appears that extensive work would be required to develop the facts necessary to support a change of these taxes. Due to staff limitations, I am not able to make an exact determination.**

**If the company desires to pursue a possible refund for the year(s) indicated above, a claim for refund, with complete supporting detail, should be prepared and submitted to me for each year that is not barred by the statute of limitations. I will review the information, and advise you of the result. Additional audit work may be required and may result in allowing or disallowing the claim or in proposing additional tax.**

**If I do not receive a statement of the corporation's position within 20 days, I will base my audit on (a domestic combination, or other basis) only and recommend whatever tax change is indicated.**

**If the corporation does not wish to pursue a tax change for these years, the Franchise Tax Board may make any adjustments necessary to properly reflect the California income in any future years.**

**Auditor**
**Telephone number**

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## 6060 NOTICE OF PROPOSED ADJUSTED CARRYOVER AMOUNT

There are situations when the tax effect of an audit adjustment will occur in the future rather than the current audit cycle due to a reduction in carryover amounts. In such a situation, we must notify the taxpayer of the reduction in order to give them an opportunity to protest the adjustment currently if they choose. R&TC Section 19043.5 authorizes FTB to issue a Notice of Proposed Adjusted Carryover Amount (NPACA) when an examination results in a reduction of a taxpayer's reported carryover amount. NPACAs are treated as if they are proposed deficiency assessments (NPAs) and the taxpayer receives protest and appeal rights even though the exam does not result in any additional tax. (Please note the NPACA is only issued when the adjustment results in a reduction to a carryover amount, not an increase.)

The taxpayer may choose to protest and appeal the NPACA currently, or wait until the revised carryover results in an NPA in some later year. The benefit of protesting an NPACA and appealing to the State Board of Equalization (SBE) currently is that the taxpayer receives a binding and conclusive determination regarding the carryover item in a more timely manner. The SBE decision binds both FTB and the taxpayer to the amount of carryover adjustment with a few limited exceptions available in the statute. If the taxpayer does not follow the SBE decision in subsequent years, the FTB can issue a math error assessment to correct the carryover amount instead of an NPA.

The NPACA is a letter that contains the amount of the carryover reduction; the revised carryover amount; modified protest procedures and the protest deadline date. Auditors should clearly communicate the process and consequences of issuing NPACAs to taxpayers and their representatives since these notices are unique to California and there is no federal counterpart.

### When to Issue the NPACA

- An NPACA should be issued when an audit results in no additional tax, but **reduces** a carryover item. (Refer to MAPM 5065 for guidance on what to do when a carryover item increases.) Regarding RARs, issue an NPACA when the RAR adjustments result in no additional California tax, but reduce a California carryover item.

- When an exam results in an NPA, a separate NPACA notice is not needed for any reduction in a carryover item for that same tax year. The carryover will be addressed in an NPA paragraph.

- When an exam of multiple years results in an adjustment to a carryover item in year 1(or one or more of the early years within the current audit cycle) and in the subsequent year(s) an NPA is being issued to reflect the carryover adjustment, which results in additional tax, a separate NPACA notice is not needed for year 1. The carryover adjustment will be addressed in a

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paragraph, which will be included in the NPA issued for the subsequent year. Record an event indicating NPACA letter was not issued since the carryovers was reflected in the NPA issued for the subsequent tax year and complete the PASS Notice Window as though an NPACA was issued. Leave status on PASS Notice Window in Pending Release.

- When an exam of multiple years results in an NPA for year 1 (or one or more of the early years within the current audit cycle, or a combination of NPA and O/A for the earlier yeas within the current audit cycle) and an adjustment to a carryover item in subsequent year(s) an NPACA should be issued for the subsequent year within the current cycle if the tax effect of that adjusted carryover item will not be realized until a future year that is beyond the current audit cycle.

- When allowing a claim for refund in full, you must also issue an NPACA for any reduction in carryover items associated with that same tax year. (Refer to MAPM 10030) The NPACA must be issued by audit staff first, then forward the claim to B/E Technical Support to be processed.

- When a claim for refund is denied in whole or in part, an NPACA will be issued for any reduction in carryover items not associated with the issue on the claim. (Refer to MAPM 10030) (*Please note that the NPACA protest period must expire before the claim denial is processed.)*

- If a taxpayer files a claim for refund because of a credit or loss issue and the claim issue is being denied in whole or in part, the denial letter gives the taxpayer appeal rights on the carryover item. It is not necessary to issue an NPACA.

**How to issue the NPACA**

1. ********** ********** ********** ********** **********

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## 6065 NO CHANGE AUDITS

It is the practice of the department to issue "*No Change* " letters on ALL completed audit years that do not result in additional tax, an overassessment, an NPACA, or an increase in a carryover amount. No Change letters will be sent directly to the taxpayer. A copy of the letter should be sent to the representative if requested. No Change letters may either be issued by the auditor, or Audit Business Support.

The field and Central Office auditors will issue No Change letters as long as there are no related case units with adjustments. If there are related case units with other than no change adjustments, Audit Business Support will issue the No Change letter.

If the field auditor issues the No Change letter, make sure that the Audit Report - Form FTB 6430 clearly indicates that the letter **HAS** already been issued. A comment should also be made in the Event Log.

**NOTE**: Refer to your specific unit procedures (i.e., is lead/supervisory review required prior to the issuance of the No Change letter?).

**NOTE**: If Audit Business Support is to issue the letter, the Audit Report - Form FTB 6430 or Sticky Note ***MUST*** clearly indicate that the letter has ***NOT*** yet been issued. A comment ***MUST*** also be made in the Event Log.

For audits of multiple tax years, when an NPA is not being issued on all years under audit, the taxpayer must be informed of the year(s) that are being accepted without any change. This may be done either through the NoChange letter, or may be noted in a paragraph included on the NPA(s) that are issued.

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## 6070 UNAGREED ADJUSTMENTS

If there is a disagreement with the auditor's proposed adjustments, the taxpayer or representative should be informed of the following protest and appeal procedures:

- The taxpayer has the option to file a protest.
- Protests must be filed in writing, within 60 days after the mailing of the Notice of Proposed Assessment.

Form **FTB 3531 PROTEST** may be used to file the protest.

- The taxpayer will be given an oral hearing, if requested. These hearings are informal and are normally conducted at one of the Franchise Tax Board offices located throughout California. If an oral hearing is not requested, the Hearing Officer assigned to the case will initiate correspondence to allow the taxpayer to submit additional information and/or documentation to properly resolve the case.
- After considering all available information, the Hearing Officer will issue a Notice of Action to withdraw, revise or affirm the proposed assessment. If the taxpayer disagrees with the Notice of Action to revise or affirm, the taxpayer has the option to file an appeal with the State Board of Equalization within 30 days from the date on the Notice of Action.
- If the Franchise Tax Board takes action to deny a claim for refund, the taxpayer has 90 days after the Claim Denial Letter is mailed to either file an appeal with the State Board of Equalization or initiate action in Superior Court.

For more information on claim procedures, see **MAPM 10000.**

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## 6080 JEOPARDY ASSESSMENT

A jeopardy assessment is issued when the collection of any tax will be jeopardized by delay. The Chief Counsel of the Franchise Tax Board must approve all jeopardy assessments in writing. The department may demand that a return for a period be filed and the tax be paid immediately regardless of whether or not the return for the period covers a full taxable year of 12 months. Also, whether or not a demand for a return has been made, the department is authorized to estimate the taxpayer's income for such period upon the basis of any available information, and to assess the tax. Penalties for failure to file, and failure to file after notice and demand, may be assessed if applicable.

R&TC Sections 19081 - 19083 provide for the issuance of a jeopardy assessment, which is immediately due and payable, and provides rights for the taxpayer.

If a taxpayer files a petition for reassessment within 60 days after the jeopardy assessment is mailed, the department shall grant the taxpayer an oral hearing, if so requested. If no petition for reassessment is filed, the jeopardy assessment becomes final upon expiration of the 60-day period. The filing of a petition for reassessment does not stay collection. Collection may be stayed only by one of the following:

1) Filing a bond or other surety, or
2) Furnishing satisfactory evidence that jeopardy does not exist.

Acceptance of bonds and other sureties are the responsibility of Collections Section. Action required because jeopardy does not exist is the responsibility of Multistate Audit. The Protest Section will act upon a petition for reassessment and recommend a notice of action on the petition.

The amount of the bond required with a petition for reassessment to stay collection and prevent the assessment from becoming final will usually be in even dollars equal to the amount of tax and penalty together with interest to the date of payment on which the stay is desired. In the case of jeopardy assessments issued with respect to taxpayers that have made an assignment for the benefit of their creditors, the amount of the required bond will be equal to the tax and penalty, plus the amount of interest reasonably expected to accrue.

## PROCEDURES FOR JEOPARDY ASSESSMENTS

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## 6090 NOTICE OF ACTION ON JEOPARDY ASSESSMENTS

### NOTICE OF ACTION ON JEOPARDY ASSESSMENTS (form FTB 5933 and form FTB 5934)

The taxpayer may file a Petition to Reassess the Liability within five days of the date of the jeopardy assessment. A Notice of Action is issued to disclose the action taken by the department on the taxpayer's petition for reconsideration of a jeopardy assessment

The notice of action informs the taxpayer that if it they do not agree with the action taken, they may file an appeal with the Board of Equalization within 30 days of the date of the notice of action.

The notice of action for suspended corporations informs the taxpayer that notice and demand is made for payment of the additional liability and the corporation must be revived before it can file an appeal with the State Board of Equalization.

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## 6100 PAYMENTS RECEIVED IN THE FIELD

**Caution: When a taxpayer indicates that they want to make a payment, the auditor should check to see if the corporation is subject to Electronic Fund Transfer (EFT) and if so, inform the taxpayer of the penalty that will be imposed if payment is made by other than EFT. The EFT Help Desk is available to assist taxpayers with their EFT payment process.**

When payments are received at audit, form FTB 6352 CORPORATION MEMORANDUM OF REMITTANCE, must be prepared in duplicate. The original and the remittance should be given to the cashier for routing to Receiving at Central Office. See **MAPM 7130** for instructions on how to complete the form.

The duplicate copy of form FTB 6352 should be stapled to the front of the form FTB 6430, to alert review that the assessment has been paid. In addition, the appropriate NPA paragraph should be used on the NPA worksheet.

Corporation Memorandum of Remittance forms are not required for Electronic Fund Transfer (EFT) payments.

Auditors should advise representatives of the approximate length of time (normally two to four months) it will take before they receive the NPAs and give them the opportunity to pay large proposed assessments at the close of the audit. Large payments may require payment by Electronic Funds Transfer (EFT).

Completed audits should be written up promptly. The taxpayer should be notified of any delay in issuing NPAs.

If the taxpayer makes a payment of the deficiency during the audit, the auditor should note the payment in event log on PASS, in the narrative report, on the 6830 NPA worksheet with the applicable NPA paragraph, and on the 6430 Audit Report Coversheet.

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## 6110 PAYMENTS RECEIVED AT CENTRAL OFFICE

If a check is received, the following procedures should be followed:

- Document the receipt and purpose of the check on the event log.
- Make a photocopy of the check and the in-lieu remittance documents, (form FTB 6350A), and include it in the audit workpapers.
- The check should be hand carried to the Bank and Corporation receiving unit (Phase I).

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## 6120 MINIMUM ADJUSTMENT

## MINIMUM ADJUSTMENT ON NOTICE OF PROPOSED ASSESSMENTS:

* * * *

## 6130 NOTICE OF REVISION

Correspondence is often received in response to an NPA and is not recorded as protest. These letters vary in nature from acknowledging the correctness of an assessment, explaining some error to be corrected, or stating taxpayer is unable to pay.

Correspondence that raises an objection to an NPA adjustment, but does not constitute a protest may be handled by the issuance of a Notice of Revision if a revision or withdrawal is in order. If no adjustment is warranted, the letter must be answered. The reply should restate our views and point out that the NPA will become final 60 days from the date of issuance unless a protest is filed within that time.

If a revision is required, a Notice of Revision should be issued through BETS. For field auditors, contact the Technical Resource Section for appropriate action.

The Notice of Revision does not prolong the 60-day protest period.

Instructions for preparing the Notice of Revision are provided in MAPM 7140.

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## 6140 POST-NPA CASES

Occasionally, after a notice is issued, the case is returned to the auditor for further factual development. Once the factual development is completed, the auditor will prepare a written recommendation to affirm, revise or withdraw the assessment. The case is then forwarded to Technical Resource Section for processing.

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## 6150 AUDIT SUBJECT TO REVIEW

When the audit is completed, the auditor should inform the taxpayer's representative that review may disclose the need for more documentation, or changes to the auditor's recommendations. If the supervisor or reviewer changes the auditor's report, the auditor must notify the representative of the revision and provide revised schedules to the taxpayer.

## CORPORATION REVIEW – TECHNICAL RESOURCE SECTION (TRS)

The TRS will serve as the final review on MSA field audit cases and certain Desk Audit cases. Prior review will have been performed by the audit supervisor who will be responsible for the quality of the audit and will indicate concurrence of the audit proposals by initialing the audit file.

The auditor's proposals will be reviewed to assure adherence with department policy on issues including, but not limited to, worldwide combination, water's-edge filing, use of multiple formulas and the use of special formulas.

For any variation from established policy, the auditor must clearly indicate a lack of significant tax change (plus or minus) or explain any other reason for the variation from policy. It is the responsibility of the reviewer to bring the applicable, correct policy to the attention of the audit supervisor involved.

## ASSEMBLING THE CASE FOR TRS REVIEW

Before sending the case to TRS for review, please assemble as follows:

- Pink Rush Tag (Notifies anyone handling the case that it is a priority)
- Audit Report Cover Sheet (Form 6430)
- Notices
  Over 250K Memo, if needed
  NPAs and/or O/As (Form 6830)
  Formal Claim
- Narrative Report
- AIPS (If referenced in the narrative)
- Printed Schedules (Final Copy)

It is at the discretion of the auditor how the rest of the file should be assembled and in what order. Also, what items should be printed.

## RECEIPT OF AUDIT CASES IN REVIEW

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As the audit cases are received, the Technical Resources Control Technician will log in the original returns on PASS. The cover sheet, form FTB 6430, will also be date-stamped at the same time to show date of receipt.

## AUDIT ADJUSTMENTS

The TRS reviewer will serve as an independent analyst of the auditor's proposed adjustments as well as the application of a particular section of the law. The purpose is to ensure that the proposed adjustments are technically correct in light of the latest department position, FTB Legal Rulings, Board of Equalization Decisions, court cases, etc.

The audit of any taxpayer is generally the responsibility of the auditor and supervisor. It is not the reviewer's purpose to substitute for the audit supervisor or to second-guess an auditor's judgment in those areas where the auditor examines an item and relies on information developed in the audit to reach a reasonable conclusion. The reviewer will be concerned with an incorrect conclusion reached based on available information or proposals recommended based on incomplete information. The reviewer may want to take exception to an auditor's failure to act in a situation where available information indicates additional audit action was appropriate, particularly when the auditor does not provide the reasons for not acting.

Any exception to an auditor's recommendation will be directed to the auditor through the auditor's supervisor.

The auditor is responsible for the accuracy of the audit case, both mathematically and technically. Cases containing errors of either nature may be returned to the field auditor for correction.

## AUDIT CASES NEEDING CORRECTIONS

Mathematical errors in schedules will be returned to the auditor for correction if they are significant and the work to correct them will require a significant amount of time. Minor changes to field audit schedules might be more efficiently corrected by the reviewer and, if so, the case need not be returned to the auditor for correction.

Some issues can be cleared up with a telephone call to the audit supervisor. If the item cannot be resolved in this manner, or if the reviewer feels there are too many issues or there is a significant item which needs clarification or correction, the reviewer should notify the audit supervisor in writing of the items in question. All issues in dispute should be set forth in detail in a memorandum to the respective audit supervisor. The case will then again be the responsibility of that field office for control purposes.

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Prior to returning a case to an auditor for correction of mathematical errors, the case will be reviewed for policy and for technical adjustment issues. This is to make sure all items in question are covered for correction in a single handling.

**FORMS PROCESSING**

Review will be responsible for the accuracy of the forms to permit in-house processing. Upon final review and approval, which will cover policy, technical issues, and any processing requirements, the Technical Resources Control Technician will route the file to the proper unit or section for disposition in accordance with the audit recommendation. The routing will include Claims Control Desk for overassessments, Business Entities Support-Typing on BETS processing for deficiencies, Business Entities Support for combined deficiencies and overassessments, and Business Entities Support for appropriate interest computations.

**ITEMS THAT NEED TO BE CLARIFIED ARE AS FOLLOWS:**

- Suspended corporations - NPA Paragraph 54477 must be on all NPA deficiency notices - refunds will not be issued. See **MAPM 6170**.
- Dissolved or merged corporations - must establish an active assumer for assessment purposes. Verify NPA heading for correct assumer/transferee name and address.
- Ensure payments received by field auditor have posted correctly. Enter appropriate payment paragraph on NPA worksheet.
- When a Walker letter (see **MAPM 6050**) has been issued, the statement "Do Not issue no change letter" should be written above the tax years on the audit report cover sheet, form FTB 6430.
- Ensure that the proper audit issue codes have been entered on the NPA worksheet.

RARS

If form FTB 6430 refers to an RAR, follow-up procedures may be necessary. If the RAR is pending and the corporation is headquartered outside California, the Technical Resources Control Technician will prepare a tickler control (form FTB 6216) and allow two years for follow-up. Data Services will make the necessary follow-up requests.

OFFSETS

RELATED NPAS AND O/AS
If a case includes all related notices which should be kept together in one package (previously referred to as a consent package), then check the "Notice Related" boxes on all related Notice(s) of Proposed Overpayment worksheets.

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AUTHORIZED OFFSET WITH RELATED NPAS AND O/AS

If the audit is agreed, contains only related notices, and the auditor has obtained **written** approval from the taxpayer, or representative to offset an overassessment to an assessment prior to expiration of the 60 days protest period:

1. Check the "Notice Related" boxes for all overassessment and deficiency assessment notices on all worksheets.
2. Write the word "OFFSET" on top of the overassessment worksheet(s) to indicate that the taxpayer's **written** authorization was received.

NPA and O/As with Unrelated Overassessment Notices

In the rare situation that the audit package contains unrelated overassessment notice(s) that should be refunded regardless if a protest is filed then,

1. Check the "Notice Unrelated" box associated with any overassessment notices that should be processed (refunded) regardless if a protest is filed.
2. Check the "Notice Related" box associated with any NPAs and O/As that should remain together.

COPY OF TAX RETURN

Occasionally, the field auditor will audit from the taxpayer's copy of the return. In such cases, the reviewer must verify that the pertinent information used by the auditor agrees with the original return as filed. This information would include net income, tax previously assessed, etc. The reviewer will enter the field auditor's initials on the return and must enter the return's DLN number where required on the NPA worksheet.

MIXED FILES

When the audit case includes both corporation returns and affiliated PIT returns, the TRS will complete its review of the corporate taxpayers and then forward the entire case to the inventory control desk in Business Entities Support for mixed files (NPAs and overassessments, claims, etc.) only for final processing of the audit case. If only NPAs are being issued, the file is sent to Business Entities for processing.

Before any completed review case leaves the TRS, the Technical Resources Control Technician should assemble it as follows:

- The number of notices must be entered on each form FTB 6830BCT by classification, e.g., NPA, O/A, N/A, etc.

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- The form FTB 6830BCT with supporting schedules to be mailed are placed on top of the folder with the latest return or other document with the correct name and address of the corporation under the NPA worksheet. The audit report and workpapers are placed inside the folder. All other returns are placed inside the folder in chronological order with the latest year on top.
- Related PIT returns and audit report for the PIT account are placed behind the corporate folder. This group will be forwarded to PIT Audit to complete the processing.
- The route slip, form FTB 7000, is placed as the first document on top of all other documents with routing instructions clearly marked.

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## 6160 DEFERMENT OF FINAL ASSESSMENT OF NPAS

It is sometimes necessary to reconsider the correctness of an NPA as a result of correspondence or other data received immediately prior to the expiration of the protest period or before the NPAs are actually made final. Ordinarily, such NPA correspondence will require one of the following actions:

- Withdrawal or revision of the NPA.
- Determination that the letter should be treated as a protest. To be treated as a protest, the letter must have been dated within the 60 days provided by law.
- Determination that the NPA is correct and that the final assessment should be issued. The taxpayer must be notified by letter that the NPA is correct unless he has indicated agreement.

The auditor shall defer the final assessment, if necessary, by taking the file to the Protest Control Desk Technician and requesting that they place a “HOLD” on the notice. Field auditors should talk to their supervisor, who can coordinate with Central Office staff to arrange the appropriate action.

Also see **MAPM 11000** for protest information.

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## 6170 SUSPENDED CORPORATIONS

A corporation may lose various rights if it is not in good standing with the FTB or the Secretary of State (SOS). Suspended or forfeited corporations are not able to file protests, appeals, or claims for refund, nor are they entitled to receive refunds (R&TC §23301, R&TC §23301.5 and R&TC §23301.6). It is important to identify potential problems early in the audit in order to give the taxpayer the opportunity to revive and get into good standing before the audit is completed. The auditor should check the status with either FTB or Secretary of State (SOS) by looking at * * * * * or using the SOS web page at : http:kepler.ss.ca.gov/list.html for all taxpayers.

After identifying a suspended/forfeited corporation, the auditor should determine why the corporation was placed in that status. If the suspension/forfeiture is in error, the auditor is to have it returned to good standing.

The auditor can learn why a corporation is suspended or forfeited by contacting the Collection Liaison in the MSA Technical Resource Section. The Collection Liaison will relay the auditor's request to BE Collections to request their help in obtaining the requested information and returning a corporation to good standing if the suspension/forfeiture is in error. If the liaisons in BE Collections wish to work directly with the auditor requesting their assistance, they can do so after the auditor had initially gone through the Collection Liaison in TRS.

If it is determined that a corporation was properly placed in suspended or forfeited status, a separate NPA worksheet must be prepared. If the auditor determines that a suspend/forfeited corporation has an overassessment, the overassessment can be offset against a balance due. However, any excess cannot be refunded. The auditor, along with the audit supervisor, needs to determine, on a case-by-case basis, how to apply the over assessment. It can be to a balance due in another year for that entity, or to another entity in the combined group within the same year. The auditor or reviewer will need to add a comment to the "* * * * *" in PASS informing Technical Support how to process the offset. In addition, a paragraph will need to be issued included on the notice informing the taxpayer of the entity suspended, that an offset was done and that the corporation will need to be restored to good standing before the expiration of the SOL before the excess, if any, can be refunded.

The taxpayer must be informed that in order for suspended/forfeited corporations to have protest rights or receive a refund, it needs to file an application for revivor for each suspended/forfeited corporation (FTB 3557).

Corporations in suspended or forfeited status by the SOS are also treated in the same manner as corporations that are suspended or forfeited by the Franchise Tax Board (FTB). The FTB will usually suspend a corporation, instead of forfeit, for reasons stated in the code sections above. The SOS will

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either suspend or forfeit a corporation for reasons stated in R&TC §23302. You can identify the status of a corporation on BETS, * * *on the FTB Account Status or SOS Status Code line.

**Note**: Intrastate apportionment must be performed to determine the separate tax liability of the suspended/forfeited corporation.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 7000 FORMS & INSTRUCTIONS

MAPM 7010 Request For Field Action (form FTB 7024)
MAPM 7020 NPA Worksheet (form FTB 6830-BCT)
MAPM 7025 Revenue Codes
MAPM 7030 Audit Issue Codes
MAPM 7040 Name And Address Of Taxpayer
MAPM 7050 Claim Recommendations (form FTB 6638)
MAPM 7060 Water's-Edge Election Fee
MAPM 7070 Audit Report Coversheet (form FTB 6430)
MAPM 7080 Authorization For Single Notices (form FTB 4523b)
MAPM 7090 Rush Action Slip (form FTB 7011)
MAPM 7110 The Abatement/Refund Memo (form FTB 6163)
MAPM 7120 Supplemental Assessments (form FTB 6213A and/or form FTB 5903)
MAPM 7130 Corporation Memorandum Of Remittance (form FTB 6352)
MAPM 7140 Notice Of Action / Revision

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## 7010 REQUEST FOR FIELD ACTION (FORM FTB 7024)

Complete form FTB 7024, Request for Field Action, for each case being referred to a Program Office. Form FTB 7024 should provide a description of all returns and any other documents being forwarded. The package being sent to the field should be assembled in the following order:

- Form FTB 7024
- Return(s)
- Audit file(s)

Do not send the following:

- Current tax clearance certificate data
- NPAs that are not yet final
- The corporate folder

A notation should be made on form FTB 7024 calling attention to any special problems identified such as imminent statute expiration or pending tax clearance action. The Tax Clearance Unit should be notified for any field referrals pending a tax clearance.

### INSTRUCTIONS TO COMPLETE FORM FTB 7024:

1. District. Enter the Program Office.
2. Earliest Statute Date. Enter the earliest statute of limitations date for the returns being sent.
3. Name, Account Number, & Years. Enter the taxpayer's name, account number, claim number (if applicable), and the years of the returns being referred to the field office. Circle the years for any returns being sent for reference. Do not include in this area any prior audit report or other information being referred to the field. These should be referenced in the Special Instructions area of the form.
4. Reason. Check the box for the appropriate reason why the returns are being sent. Indicate in the area designated whether the return is being sent to the field due to the taxpayer's or the field auditor's request.
5. Special Instructions. The comments here may include a detailed listing of the potential areas of examination or any other special instructions for the field auditor. If a prior audit report and/or other information is being sent along with the returns, indicate so in this area.
6. Send form FTB 4102 or Special Letter. Identify whether a letter is being sent to notify the taxpayer and/or the taxpayer's representative that the returns are being sent to the field office. A letter should only be sent to the taxpayer when it is necessary for the taxpayer to know that its returns are being transferred to the field for examination.

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7. Name and Address of Taxpayer or Taxpayer's Representative. If the auditor is aware of a change in the taxpayer's and/or the representative's address, it should be indicated and the address updated on BETS and or TI.

Once form FTB 7024 has been completed, the following procedures should be followed:

- If the case being sent to the field is a refund claim, the case should be taken to the Claims Control Desk. All other cases, except water's-edge cases (which are worked by the water's edge team) should be submitted to your lead auditor. The lead auditor will then take the case to the Work Control Desk.
- The Claims Control Desk or the Work Control Desk will route the cases to the Program Office indicated on the form.
- The Program Office receiving the case will update the PASS file upon receipt of the return.

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## 7020 NPA WORKSHEET (FORM FTB 6830-BCT)

Form FTB 6830-BCT is to be used in preparing Notices of Proposed Assessment (NPA) and Overassessments (O/A) for corporate taxpayers. (See **MAPM 7060** for procedures for the Water's-Edge election fee.) This worksheet is available in the * * * * * * * * * * * * * * * * * * * * *.

It is important that the auditor check the account status on BETS, * * for each taxpayer in the combined group, prior to preparing the form 6830-BCT worksheet. If the group contains a suspended taxpayer, a separate notice must be issued to the suspended taxpayer. See **MAPM 6170** for information about suspended corporations.

It is important that the auditor verify the previously assessed tax on BETS, * * before preparing the form 6830-BCT worksheet.

**INSTRUCTIONS:**

1. NOTICE UNRELATED & NOTICE RELATED. Check the proper box to indicate if the notice is related or unrelated to another notice that is being issued at the same time.

   **Related Notice:** any notice associated with another notice that should be processed together regardless of any subsequent action such as a protest or appeal.

   **Unrelated Notice:** any notice resulting in a bill, refund/offset that should be processed independently of other notices, regardless of any subsequent action such as a protest or appeal.

   Please note: Most notices will be related notices. The unrelated notice will be the exception.

2. DO NOT MAIL NPA. Check here if additional tax was paid and an NPA is not to be mailed. Use payment paragraphs 50699--50702. The notation "Do not type" should be written across the face of the worksheet in instances where the NPA is not typed.

3. AUTHORIZED OFFSET. Check here if the taxpayer has authorized a deficiency to be offset by an overpayment.

   If the audit is agreed, contains only related notices, and the auditor has obtained **written** approval from the taxpayer, or representative, to offset an

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overassessment to an assessment prior to expiration of the 60 days protest period then:

Check the "Notice Related" boxes for all over-assessment and deficiency assessment notices on all worksheets.
Write the word "OFFSET" on top of the over-assessment worksheet(s) to indicate that the taxpayer's written authorization was received.

4. ASSUMER. Check here if there is an assumer. See **MAPM 7040** for assumer instructions.

5. FT & CIT. Check the box indicating whether the notice is issued under the Corporation Tax Law or the Corporation Income Tax Law.

6. O/A & J/A. Check O/A for an overassessment and J/A for jeopardy and bankruptcy cases. See the following sections for more detail regarding overassessments, jeopardy, and bankruptcy: **MAPM 10000**, **MAPM 6080**, AND **MAPM 14000**.

7. ASSUMER ID NO. Enter the Social Security number or corporation number of the assumer.

8. CORP NO. Enter the California corporate number. Corporation numbers must contain seven digits. Do not include the prefixes "D", "F", "NQIT", or "NQFT, but do include the prefixed "NB" (National Banks), "FSLA" (Federal Savings and Loan Associations). Or "FPCA" (Federal Production Credit Associations).

9. J/A NO. If a jeopardy assessment is being issued, enter the form to be used and circle it in red pencil: form FTB 5837 or form FTB 5840. **MAPM 6080**

10. SOL. Enter date statute expires if other than normal statute or statute extended by State waiver or if the normal statute will expire within four months after the file is submitted to Review.

11. NO. OF NOTICES. Enter the number of Notices of Proposed Assessment (NPAs) and the number of Overpayments (O/As) being sent to the taxpayer or affiliated group.

| Example | |
|---|---|
| 2 NPAs Only | write NPA 2 |

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| | |
|---|---|
| 2 NPAs and 1 O/A | write NPA 2, OA 1 |
| Do Not Write | 1 of 3, 2 of 3, etc. |

12. NO. OF ENC. Indicate the total number of enclosures to be mailed; i.e. 7 audit schedules.

13. TXP. Enter "T/P" if the name and address of the taxpayer shown on the taxpayer's latest return is the same as shown on the taxpayer's BETS account. Show the correct name and/or address on the form 6830-BCT when the address on the latest return in the file is incorrect. If the corporation has dissolved, withdrawn, liquidated, etc., see **MAPM 7040**.

    **CAUTION:** If the name or mailing address of the corporation has changed, it is the auditor's responsibility to verify that BETS is corrected immediately. BETS transactions may be completed by the public service staff, the audit support staff, or the auditor as designated by the program manager. The California Secretary of State must approve a name change.

    a**.** The name of the individual or corporation presently liable for payment of the assessment will appear in the heading.

    b**.** Never include "formerly known as ---------" or "DBA" in the heading.

    c. In the case of refunds, the taxpayer will be the original corporation making the overpayment.

14. CC REP. The auditor should indicate the name and address of the representative to whom copies of the NPA should be sent. A copy should be sent when the auditor was working with an outside representative. Even if the representative requests that the notice be sent in their care, the original should generally be sent to the taxpayer. A copy should not be sent to a person who is not authorized to represent the taxpayer since this would violate the confidentiality provisions of the law.

    A cc may be sent to a program office or other staff requiring a copy of the NPA. This may facilitate follow-up. Example writing "cc: Long Island, Attn: A. Staff" will result in a copy being sent to auditor "A. Staff" in the Long Island Program Office.

15. Taxable YR. The taxable year is entered in every case. Enter the month and

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year for all Taxable years. Never use 19XX for a calendar year taxpayer. (Example, 12/XX instead of 19XX).

16. DLN NO. Enter the seven-digit number stamped at the top of the return. (Required by Research Bureau).

17. COPY TO FEDERAL. Check this box if a copy of the NPA is to be forwarded to the Internal Revenue Service.

18. REV. CODE. Enter the seven-digit revenue code. (See **MAPM 7025** for the revenue codes.)

**ORIGINAL RETURNS AND AMENDED RETURNS FOR ADDITIONAL TAX**

See **MAPM 7025**.

**RAR ASSESSMENTS**

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**CLAIMS:**

- For a formal claim, enter the issue code on form FTB 6638 or NPA worksheet.
- For the lists of issue codes, see **MAPM 7030.**

20. NET INC AS REPORTED; UNITARY BUS INCOME; INC PER SCH____: Check the box for starting income, if applicable.

    Start with net income after state adjustments as reported for general corporation audits; unitary business income for apportionment audits; income per Schedule I when supplemental schedules for computations on apportionment cases are used.

    If net income or unitary business income has been revised previously, enter phrase, such as "per amended return", "per NPA dated _____" or "per NC (Notice of Cancellation) dated _____". For alternative starting income, which is warranted by the nature of the circumstances or adjustments, see Item 21.

Regardless of the starting point, income shown must be pre-apportionment.

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Note: When enter amounts on O/As, you may round to the nearest dollars. On NPAs it's necessary to include dollars and cents.

21. ITEM ADJUSTMENTS. Adjustment description and written paragraph explanations are entered here. The adjustment items should be described sufficiently so the taxpayer can identify the item adjusted.

    When separate schedules are attached, rather than making several computations on form FTB 6830, the paragraph explaining the adjustments should be on form FTB 6830 with "per Schedule I attached" added. (This will usually apply to smaller audits or Desk Audits.) In the field, especially on large case audits, the MSA Principal schedules are provided to the taxpayer or the taxpayer's representative, prior to the close of the audit. In this situation, a paragraph will be added referencing those schedules previously furnished rather than attached.

    If the description for the starting income in Item 20 is not appropriate, enter the appropriate phrase here.

22. APPORTION_____% TO CALIFORNIA**.** Enter the California apportionment percentage.

23. NONBUSINESS INC. WHOLLY ATTRIBUTABLE TO CA: Enter the nonbusiness income allocated to California.

24. CONTRIBUTION ADJUSTMENT: Enter Contribution Adjustment.

25. REVISED STATE NET INCOME**.** The amount of the revised net income must be entered in all cases. When special computations are required on combination apportionment audits, make reference to a schedule, when appropriate. Write "Per Schedule I" if a copy was provided to the taxpayer. (Note: NEVER put dollar amounts in the cents column.)

26. PASSIVE INC.; NOL C/O DED.; LARZ/EZ NOL; DISASTER LOSS: Check the appropriate box to indicate if the following income deduction item(s) are reported: Passive Income Deduction; NOL Carryover Deduction; LARZ, EZ, LAMBRA NOL Carryover Deduction; and Disaster Loss Carryover Deduction.

    You must include the allowable amount of any of the above income deductions (for all General and Apportioning Corporations) regardless of

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whether you are adjusting or not adjusting them. If these income deduction items are not reported, Audit Support and BETS * * * * * * * * * will assume the taxpayer has no NOL carryovers, etc. to offset net income and create an incorrect NPA.

27. REVISED TAXABLE NET INCOME. Enter the revised taxable net income after any income deduction items were deducted.

28. TAX AT ____ MINIMUM TAX, PREPAYMENT TAX. The amount of tax will be entered in all cases, unless supplemental schedules are referenced. The tax rate will be entered in all cases where a standard or composite rate is applicable. On financial tax computations and special combination and apportionment audits, additional computations are required and should be shown in Item 37 (paragraph area), keyed in with an asterisk or on a supplemental schedule.

    If minimum tax or prepayment tax applies, check the box located to the left for that item and either,
    - Separately list the total minimum tax on the "Total Amount of Minimum Tax" line, or enter prepayment tax amount on the "Prepayment Tax" line, or
    - On the "Tax at" line state "Per Sch I" instead of listing the tax rate if a supplemental schedule is used.

    In combined reporting situations, where more than one of these may apply refer to the schedule furnished to the representative at the "Tax at" line. (For example, enter "Per Sch I".)

    If the taxpayer is referred to a schedule, do not check the box to the left of "Tax at".

    The only time the "Tax at" box should be checked is when the "Revised Taxable Net Income" times the tax rate equals the tax stated on the notice.

29. LESS TAX CREDITS. Enter tax credit(s). If a change is proposed, attach a schedule. If MIC, LARZ, or R & D credits apply, check the box. For other miscellaneous credits, check the box and enter the name of the credit.

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30. NET TAX. The net tax amount is only required if different from total tax.

31. AMT and OTHER TAXES. Check the appropriate box if Alternative Minimum Tax or other taxes apply. Enter the amount of the AMT or other taxes. If a change is proposed, attach a schedule showing the revised computation. If other taxes apply, enter a description of the tax. Use descriptions such as: "S corporation tax on certain capital gains", "Tax on built-in gains", or "Tax on excess net passive investment income." Do not refer to law sections or regulations on this line, such as "Tax imposed under R&TC Section 23811."

32. TOTAL TAX. Enter total revised tax plus AMT, and other taxes.

33. PREVIOUSLY ASSESSED. Enter the total amount of tax previously assessed, including AMT and other taxes (enter a previously proposed overassessment, which remains unpaid, to the left of the money column.) For combined reports, list corporate names, numbers and amounts for each corporation included in the total previously assessed either with an asterisk on form FTB 6830 or attach schedule to form FTB 6830. If separate NPAs are being issued or when intrastate apportionment is applied to taxpayers that had been included in a group filing (under Schedule R-7), the previously assessed tax for each taxpayer should be determined in accordance with intrastate apportionment principles as explained in FTB Legal Ruling 95-2. Previously assessed tax may be from the original return, amended return or previous NPA. The auditor must verify the amount of the previously assessed tax by checking the taxpayer's account on BETS, * * , and cannot just rely on the tax amount that appears on the face of the original tax return.

**CAUTION: To reduce errors, the auditor, supervisor and reviewer must review taxpayer's current account status.** A check of the taxpayer 's BETS (* * ) account may reveal changes to the original self-assessed amounts. This is important when the entire audit file is unavailable or when relying on representative's copy of return. It is also important for financial corporations where the rate may be changed after the return is filed.

For old years where the tax information has been purged off the BCM or BETS, request the information via the Business Entities' Home Page http://* * * * * * * * * * * * * * * * * *

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An NPA does not become final until the expiration of the 60-day protest period or the expiration of the 30-day period after issuance of a Notice of Action of Affirmation or Revision.

34. TOTAL ADDITIONAL TAX or OVERASSESSMENT. Check which box applies and enter the total additional tax or overassessment.

    If there is no penalty, this will be the last line filled in for a deficiency, overassessment, or Notice of Action revising an NPA.

    An overassessment will be entered to the left of the money column, in brackets.

35. PENALTY. Complete if any penalties apply. Enter percentage and a description of the penalty. Use descriptions such as "Late Filing", "Accuracy Related", etc. rather than the section of the law.

Generally, the penalty will be computed only on the additional tax. Exceptions are:

a) If it is determined there should have been a delinquent filing penalty, but the original return was assessed for tax only;

b) Fraud penalty is assessed and there has been a previous NPA or amended return; or

c) Penalty for failure to furnish information requested applies to only a portion of the deficiency. (If a representative fails to submit information, a request should be addressed to the taxpayer before the penalty is imposed.)

Accuracy related penalty is applied to the portion of the tax associated with a particular issue.

36. TOTAL ADDITIONAL TAX AND PENALTY. Enter the total additional tax and penalties. If this is a net overassessment, enter to the left of the money column, in brackets.

    When the taxpayer pays the additional tax at the time of the audit, interest should be computed to the date of payment, however no interest figure should be entered on the form FTB 6830. NPA paragraphs 50706

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or 50707 should be used to indicate to the taxpayer the portion of the payment being applied towards interest.

37. PARAGRAPH NUMBER(S). Paragraph codes, typed or handwritten paragraphs, and short computations may be entered here. If calculations must be made for items 22-36, the computations may be shown in this area and keyed to the line number with an asterisk.

    If the adjustments were based on field audit schedules previously provided to the taxpayer or the representative, NPA paragraphs 52656 or 52657 may be used.

    If payment is secured prior to issuance of the NPA, enter the appropriate paragraph to notify taxpayer of payment received. Also see **MAPM 6100** and **MAPM 6110** for processing payments.

38. PREPARER AND DATE**.** The auditor's name and date are entered here.

39. REVIEWER #1 AND DATE; REVIEWER #2 AND DATE**.** Enter the names of the reviewers who performed the first-level and second level reviews and the respective dates when their reviews are complete.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 7025 REVENUE CODES

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## 7030 AUDIT ISSUE CODES

The four-digit code is based on the five-digit CR&TC statute section numbers. Dropping the first digit of the law section, as follows, changes the five-digit law section into a four-digit audit Issue Code:

| STATUTE SERIES | ISSUE CODE | STATUTE |
|---|---|---|
| 23000 | 3000 | B&C Tax Laws |
| 24000 | 4000 | B&C Income and Deductions |

MSA audit issues employ a unique series of numbers (see attached list) to specifically identify the audit issues involved. For example, R&TC Section 25101 is too broad when dealing with taxpayer combinations (e.g., worldwide combinations, diverse businesses, etc.)

If a standard NPA paragraph is used on the NPA worksheet, use the NPA Paragraph Manual to determine the applicable issue code. This manual has been revised to incorporate these codes.

**NPAs/O/As**

For every NPA or O/A issued, determine the applicable issue codes. Up to three codes may be used for each year (only one for O/As). If more than one issue code is applicable, use the most predominant code first. Both the NPA worksheet and the formal claim worksheet contain specific boxes for issue codes.

APPORTIONING AUDIT ISSUE CODES

| **Assessment Issue** | **Issue** |
|---|---|
| Allocation & Apportionment General | 0000 |
| **Doing Business** | |
| Doing Business Within and Outside California | 0010 |
| Doing Business - Agency Relationships | 0011 |
| Doing Business - Independent Contractors | 0012 |
| Commercial Domicile | 0013 |
| Legal Domicile | 0014 |
| **Income Adjustments** | |
| Foreign Currency Translation | 0020 |
| Interest Offset | 0021 |
| Contribution adjustment | 0022 |
| DISC/FSC Adjustments | 0023 |

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|---|---|
| Safe Harbor Lease Adjustments | 0024 |
| Michigan Single Business Taxes | 0025 |
| Section 78 Gross-Up | 0026 |
| Foreign Taxes | 0027 |
| Income adjustments - Miscellaneous | 0099 |
| **Factor Adjustments** | |
| Property Factor | |
| Capitalized Rents | 0103 |
| Construction/Work in Progress | 0104 |
| Foreign Currency Conversion | 0105 |
| Government Property | 0106 |
| Idle/Nonbusiness Property | 0107 |
| In Transit | 0108 |
| Inventories | 0109 |
| Land | 0110 |
| Partnership Property | 0111 |
| Progress Billings | 0112 |
| Other | 0199 |
| Payroll Factor | |
| Base of Operations/Control | 0200 |
| Compensation | 0201 |
| Construction of Assets | 0202 |
| Exclusions | 0203 |
| Foreign Affiliates | 0204 |
| Independent Contractors | 0205 |
| Mobile Employees | 0206 |
| Operation of Government Plant | 0207 |
| Paid or Accrued | 0208 |
| Partnership Share | 0209 |
| Related to Nonbusiness Income | 0210 |
| Intercompany Eliminations | 0211 |
| Other | 0299 |
| Sales Factor | |
| DISC/FSC | 0300 |
| Dividend income | 0301 |
| Double Throwback Sales | 0302 |
| Gain/Loss on Sale of Assets | 0303 |
| Government Facility/Cost+Fee | 0304 |
| Gross Receipts | 0305 |
| Installment Sales | 0306 |
| Intercompany Elimination's | 0307 |

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| | |
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| Interest Income | 0306 |
| Leases | 0309 |
| Other Miscellaneous Income | 0310 |
| Partnerships | 0311 |
| Receipts from Services | 0312 |
| Receipts from Intangibles | 0313 |
| Rental Income | 0314 |
| Royalty Income | 0315 |
| Sales to US Government | 0316 |
| Throwback Sales | 0317 |
| Other | 0399 |
| Special Formulas | |
| Air Transportation | 0400 |
| Banks and Financials | 0401 |
| Commercial Fishing | 0402 |
| Franchisers | 0403 |
| General/Financial | 0404 |
| Long Term Contracts | 0405 |
| Motion Picture/TV | 0406 |
| One or Two Factors | 0407 |
| Partnerships | 0408 |
| Railroads | 0409 |
| Sea Transportation | 0410 |
| Special Industries | 0411 |
| Trucking Companies | 0412 |
| Other | 0499 |
| **Business/Nonbusiness Income** | |
| Dividends | 0500 |
| Gains/Losses | 0501 |
| Interest Income | 0502 |
| Nonbusiness Expenses | 0503 |
| Partnership | 0504 |
| Rental Income | 0505 |
| Royalty Income | 0506 |
| California Income | 0507 |
| Other | 0599 |
| **Combinations/Decombinations** | |
| Domestic Parent with Worldwide Activities | 0600 |
| Full Decombination of Foreign Subsidiaries | 0601 |
| Partial Decombination of Foreign Subsidiaries | 0602 |
| Full Combination of Foreign Subsidiaries | 0603 |

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Partial Combination of Foreign Subsidiaries 0604
Other Domestic Parent Combination/Decombination 0609
Foreign Parent with Worldwide Activities 0610
Full Combination of Domestic Subsidiaries 0611
Partial Decombination of Domestic Subsidiaries 0612
Full Worldwide Combination of all Subsidiaries 0613
Partial Worldwide Combination 0614
Barclay's "One Voice" Issues 0615
Other Foreign Parent Combination/Decombination 0619
Decombinations 0620
Diverse Business - Lines of Business 0621
Diverse Business - Multiple Formulas 0622
Diverse Business - 482 Allocation 0623
Instant Unity 0630
Ownership/Control 0631
Holding Company 0632
Other Decombinations 0639
Combinations 0640
Ownership/Control 0641
Strong Central Management 0642
Exchange of Product/Flow of Goods 0643
Vertical/Horizontal Integration 0644
**Water's Edge**
Water's-Edge - 80/20 Corporations 0700
Water's-Edge - Branch Separate Accounting 0701
Water's-Edge - Controlled Foreign Corporation 0702
Water's-Edge - Domestic Disclosure Spreadsheet 0703
Water's-Edge - Earnings & Profits 0704
Water's-Edge - Foreign Investment Interest 0705
Water's-Edge - Transfer Pricing 0706
Water's-Edge - Election Fee 0707
Dividend Exclusions Section 24402 0720
Dividend Exclusions Section 24410 0721
Dividend Exclusions Section 24411 0722
Dividend Exclusions Section 25106 0723
Dividend Exclusions Subpart 'F' 0724
Dividend Exclusions Gross-ups 0725
Dividend Exclusions Other 0729
Federal Tax Treaties 0730
Pricing Goods - Tangible 0731
Pricing Goods - Intangible 0732

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|---|---|
| Water's-Edge Combination - Other | 0799 |
| **Exempt Organizations** | |
| Exempts - R&TC Section 23701(h), IRC §501(c)(2) | 0902 |
| Exempts - R&TC Section 23701(d), IRC §501(c)(3) | 0903 |
| Exempts - R&TC Section 23701(f), IRC §501(c)(4) | 0904 |
| Exempts - R&TC Section 23701(a), IRC §501(c)(5) | 0905 |
| Exempts - R&TC Section 23701(e), IRC §501(c)(6) | 0906 |
| Exempts - R&TC Section 23701(g), IRC §501(c)(7) | 0907 |
| Exempts - R&TC Section 23701(b), IRC §501(c)(8) | 0908 |
| Exempts - R&TC Section 23701(i), IRC §501(c)(9) | 0909 |
| Exempts - R&TC Section 23701(l), IRC §501(c)(10) | 0910 |
| Exempts - R&TC Section 23701(j), IRC §501(c)(11) | 0911 |
| Exempts - R&TC Section 23701(c), IRC §501(c)(13) | 0913 |
| Exempts - R&TC Section 23701(n), IRC §501(c)(17) | 0917 |
| Exempts - R&TC Section 23701(s), IRC §501(c)(18) | 0918 |
| Exempts - R&TC Section 23701(w), IRC §501(c)(19) | 0919 |
| Exempts - R&TC Section 23701(q), IRC §501(c) (Repealed for TYE beginning on/after 1/1/1999) | 0920 |
| Exempts - R&TC Section 23701(x), IRC §501(C)(25) | 0925 |
| Exempts - R&TC Section 23701(r), IRC §527 | 0927 |
| Exempts - R&TC Section 23701(t), IRC §528 | 0928 |
| Exempts - R&TC Section 23701(k), IRC §501(d) | 0929 |
| Exempts - R&TC Section 23701(m), (Repealed for TYE beginning on/after 1/1/1988) | 0930 |
| Exempts - R&TC Section 23701(p), IRC §401(a) | 0931 |
| Exempts - R&TC Section 23701(v) | 0932 |
| Exempts - R&TC Section 2370l(u) | 0933 |
| Exempts - Revocation | 0999 |

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## 7040 NAME AND ADDRESS OF TAXPAYER

1. Use the exact name of the corporation and enter the corporate number in the line provided. When there is a corporate assumer and/or transferee, a transaction needs to be performed in BETS * * * * * * * * *to enter the assumer's account number.

2. If an assumption of liability was made by another corporation or by individuals, the corporate name and number will be shown as the taxpayer and the assumers will be added to the heading as assumer and/or transferee. This particular format will be used in most situations. For example:

*White Corporation No. 0876540, Taxpayer, and*
*Green Corporation No. 0765430, Assumer and/or Transferee*

or

*White Corporation No. 0876540, Taxpayer, and*
*John Doe, Richard Roe, and John Smith Assumers and/or Transferees*

3. If the corporation has dissolved, withdrawn, or become entirely inactive as a result of a reorganization, and the adjustment is to be reflected on the accounts of a transferee corporation, the notice will be prepared in the name of the transferee corporation as successor in interest to the transferor corporation. The corporate number will be included in the heading. For example:

   *Green Corporation No. 0123456*
   *Successor in interest to Brown Corporation No. 0567890*

   If there are two successors in interest, only the last two corporations are shown in the heading and the first corporation will be shown in the net income line at the beginning of the notice. For example:

   **"Heading"**

   *Black Corporation No. 0345678*
   *Successor in interest to Green Corporation No. 0123456*

   **"Body of notice"**

   *Net income of Brown Corporation, No. 0567890 which was succeeded to by Green Corporation, $100,000.00.*

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4. If transferee liability is established as a means of collection, the corporation name and number is shown as the taxpayer and the transferees are added to the heading. Use only the principal transferees, or if ownership of stock was evenly divided, list the transferees who are most promising for collection. For example:

   *White Corporation No. 0876540, Taxpayer, and*
   *John Doe, Richard Roe, and John Smith Transferees.*

   **Copies will be mailed to each transferee as well as to the corporation. Show the address of each transferee. Use any available space on the form to show the transferees' mailing addresses. Circle them to indicate to the typist that the addresses are not to be typed as part of the NPA.**

5. If a notice has been issued to the taxpayer and it later becomes necessary to issue the SAME notice to assumers or transferees, it should be issued as shown in the following examples:

   *John Doe, Richard Roe, and John Smith Transferees of ABC Corporation No. 0109290.*

   *John Doe, Richard Roe, and John Smith Assumers and/or Transferees of ABC.*

In such cases use "Previously paid" rather than "Previously assessed," especially where the taxpayer has not paid all of its self-assessed tax liability. Copies will be mailed to each transferee or assumer, but not to the taxpayer corporation.

6. In the case of refunds, the taxpayer will be the original corporation making the overpayment, regardless of subsequent assumers, transferees, successors in interest, etc. For example:

   *ABC Corporation (Taxpayer making overpayment) c/o XYZ Corporation*
   *(Successor or assumer) Address of XYZ Corporation*

   Where the amount being refunded was assessed to the assumer, transferee, successor in interest, etc., that corporation will be shown as the taxpayer.

7. A notice issued to a bankrupt corporation should be headed in the usual manner. If the receiver requests a copy of the notice, indicate on form FTB 6830. Add form FTB 5836 with bankruptcy number above the boxes on form FTB 6830. Following is an example of the heading for a bankrupt corporation:
   *ABC Corporation, No. 0109290 c/o John Doe, Receiver (or referee) in bankruptcy*

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## 7050 CLAIM RECOMMENDATIONS (FORM FTB 6638)

Form FTB 6638 is to be used in all cases where a claim for refund is either being allowed or denied **IN FULL**. The form is available in * * * * * * * * * * * * * * * * * * * * *.

For information on when to use this form see **MAPM 10000**.

**Form FTB 6638 - INSTRUCTIONS.**

1. Taxpayer Name: Use the exact name of the corporation.

2. Taxpayer ID: Enter the corporate number.

3. Created By: Enter the auditor's name.

4. IncomeYear(s)**:** The taxable year is entered in every case. Enter the month and year.

5. Cc(s): The auditor should indicate the name and address of the representative(s) to whom a copy of the notice should be sent. A copy should be sent when the auditor is dealing with an outside representative.

6. Reviewer & Review Date: Enter the reviewer's name and the date the review was completed.

7. Deny Claim For Refund For: Place an X in this box only if the claim is to be denied in full. An explanation of the denial must be made. See #9. Enter the tax year and the amount of the claim. It is not necessary to put a claim number.

8. Allow Claim For Refund For: Place an X in this box only if the claim is to be allowed in full with no increase or decrease in the amount requested in the claim. NPA paragraph 50663 will automatically be typed as an explanation. Enter tax year, amount of claim, and revenue code. (See MAPM 7025 for revenue codes.) It is not necessary to put a claim number. Indicate if the claim is related or unrelated to another notice issued at the same time.

9. Explanation:

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a. Denied with no other action--NPA paragraph 50621 should be used followed by an explanatory paragraph.
b. Denied with an NPA also being issued on the same year, or different year with the same issue--the denial letter will not be issued until the NPA goes final. This prevents the taxpayer from having to appeal a claim denial concurrently with filing a protest.
   (1) Denial with NPA on same year--Use NPA paragraph 50625.
   (2) Denial with NPA on same issue on a different year--Use NPA paragraph 50621 with explanatory paragraph, and a note "Do not type until concurrent NPA on taxable year _____ goes final."
c. Allowed in full. NPA paragraph 50663 will automatically be typed. If an additional explanation is needed, it should be written in this area.

10. Paragraph: Indicate whether NPA paragraph 53400 should be used by placing an "X" in the box and inserting the month and year for the taxable year(s) to which it applies.

**NOTE:** Include form FTB 6638 in the completed report package. See MAPM 6010.

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## 7060 WATER'S-EDGE ELECTION FEE

If the Water's-Edge election fee is modified as a result of an audit of other issues, or if the election fee is modified as a result of an audit of the election fee itself, an NPA or O/A will be issued to reflect the changes. (The water's-edge election fee was only applicable for years beginning on or after 1/1/1988 through years beginning before 1/1/1994. The fee was repealed for years beginning on or after 1/1/1994.) However, since the Water's-Edge election fee data is posted to a different system than the BETS system, a separate NPA or O/A must be prepared, if applicable. The NPA worksheet (form FTB 6830-BCT) will be prepared in the same manner as usual except for the following:

### REVENUE CODE

The revenue code is prepared in accordance with **MAPM 7025** except for the fourth and fifth digits (program code). The following code is applicable for revising the Water's-Edge election fee and penalties:

W/E FEE 76

If the audit adjustments result in an overassessment, the program code should not be the same as the revenue code of the original return. The fourth and fifth digits of the code should be changed to be Water's-Edge as above.

### PREVIOUSLY ASSESSED WATER'S-EDGE FEE

The amount of previously assessed fees may not be obvious on the tax return. Generally, it would be reflected on California Form 100-FEE-A. The auditor should contact the designated program specialist in MSA Technical Resource Section to request a FAX copy of the taxpayer's water's-edge account transcript, in order to verify the previously assessed water's-edge fees. The water's-edge fee database is maintained with a separate computer system and is not available on BETS.

### PENALTIES

The Water's-Edge election fee is subject to the same interest and penalties as any tax deficiencies. See California Revenue and Taxation Code Section 25115(h) that was in effect prior to its repeal. The same procedures used to prepare an NPA apply. The more common types of penalties that might apply would be the failure to furnish and late filing penalties. Any questions on applying penalties should be directed to the MSA Technical Resource Section Unit.

### PARAGRAPH NUMBER(S)

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There are no prepared paragraphs for Water's-Edge audit adjustments; therefore, the auditor must compose a paragraph appropriate for the adjustment. A sample paragraph is shown on the exhibits.

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## 7070 AUDIT REPORT COVERSHEET (FORM FTB 6430)

The form FTB 6430 is the cover sheet for the auditor's report. It also serves as the transmittal document to Technical Resource Section. It is available in * * * * * * * * * * * * * * * * * * * * * * * * *.

### INSTRUCTIONS

1. **Program Office –** Automatically populates.
2. **PUC** – Automatically populates.
3. Earliest Statute **-** Enter the earliest date on which the statute will expire for making an assessment or allowing a refund for any of the returns under audit in the affiliated groups. If earliest statute applies to an affiliate put "AFFL:" below the expiration date. If the statute will expire within four months after the file is submitted to review, circle the statute in red.
4. **Identification No** – PASS automatically populates this section with the taxpayer's full name, address and identification number.
5. **Boxes**
   (a) **Claims -** Check if there is a formal or informal claim (any overassessment other than generated by audit).
   (b) **Non Review** - Check if the case does not require TRS review.
   (c) RAR Pending – Provide the wokpaper reference for the IRS contact and substantiation of the federal exam.
   (d) **Taxpayer's Copy** - If the original return is not in field and audit is made from representative's retained copy, send copy of return, clearly marked "copy" to Central Office. At Central Office the return must be located for verification of previous assessment.
   (e) **Bankruptcy** - Check only if case in which the period for filing bankruptcy claim has not expired. Notices must be issued promptly. The final date for filing the claim is six months after the date set for the first creditors' meeting, except for arrangements under chapter proceedings (e.g. Chapter 11, 12, 13). In cases involving arrangements under chapter proceedings, the claim must be filed before the plan of arrangements is confirmed. If under a Chapter 11 proceeding (only), a corporation is adjudicated rather than having its plan confirmed, all claims must be filed within 60 days of the date of Notice of Adjudication (Bkcy Act Sec. 378, Chap. 11). The final date for filing the claim should be entered at item 18 "Special Remarks."
   (f) **Protested -** Check if the file includes a case in which an NPA previously issued is under protest and the auditor is recommending action to be taken on the protest. Files with "Docketed" protest must be approved through Legal's Protest Section. Do not check this item to indicate that the taxpayer will protest.
   (g) **Taxpayer's Position** – Double click on the postion listing and make a choice from the drop down list.

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6. **Taxable year** – Enter the years examined, starting with the earliest year first.
7. **Statute Extended** - Enter the SOL statute date or the extended SOL date for each year under audit. If no SOL date, explain why, such as fraud or no return. If extended by a Federal waiver, this should be shown and should be entered as "FW 6/30/0X" (with the Federal date and not the date six months later applicable for State purposes under Section 25663a). If the six months statute applies under Section 25674, the actual statute date should be entered here. If the statute has expired on a referenced return, enter a dash.
8. **Federal Action** - "RAR" should be entered if the report is available. If there is information the IRS is making or will make an audit, write "Pend" on this line. If there is no indication a Federal audit will be made, write "No." If there is an RAR pending for any other years, show this information in "Special Remarks" and check "See Remarks" at right.
9. **Def or O/A** – Enter deficiency amount of tax and penalty in whole dollars. Interest is only included if payment has been received. This includes EFT payments. Writer overassessment amounts (including penalties) in parenthesis.
10. **Names and Dates.** The auditor's name and address automatically populate. The date submitted, the reviewer's name and number must be manually entered.
11. **Special Instructions –** List all related returns in this section, including name, CCN and tax years. This is important so that the files will be kept together through processing.

    This section can also be used to call attention to a special item.

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## 7080 AUTHORIZATION FOR SINGLE NOTICES (FORM FTB 4523B)

In all audits where California reporting entities have filed separate returns and are being combined by audit, or have filed a combined report and are being decombined by audit, an Authorization for Single Notice (form FTB 4523B) should be secured from the taxpayer. This form is found in the * * * * * * * * * * * * * * * * * * *.

If the taxpayer does not sign the authorization, the auditor must prepare an intrastate apportionment of the income and issue separate notices for each of the California reporting entities that filed separate returns.

Note: As long as a Schedule R-7 for 1992 or subsequent was executed, the blanket waiver will generally be acceptable even if the auditor is proposing to "decombine" the taxpayers or if one or more of the taxpayers have been sold. Judgment should be used of course -- if a taxpayer is asking to terminate their R-7 relationship, the auditor should obtain separate waivers to avoid potential problems. (Likewise, single notices can be mailed to taxpayers filing on a 1992 or subsequent Schedule R-7 regardless of whether a taxpayer has been decombined or sold, but the auditor should consider issuing separate notices if the taxpayer so requests.)

If separate notices are issued, payments of previously assessed tax will be allocated to the California entities in accordance with the Schedule R-7 filed with the original return if intrastate apportionment was used to prepare the original return. If intrastate apportionment was not used, the previously assessed tax must be assigned back to the members based on intrastate apportionment principles (See Legal Ruling 95-2).

**INSTRUCTIONS:**

1) Enter the Taxable years for which the notices are to be issued. One authorization may be used to cover all years under audit.
2) Enter the name of the corporation that has been designated to receive the notice(s). This will usually be the key corporation.
3) Enter the address of the designated corporation where the notice(s) is to be mailed.
4) Enter the California corporation number of the designated corporation.
5) Enter the federal employer number of the designated corporation.
6) Enter the name and California corporation number of each California reporting entity, which is covered by the single notice.
7) The signature of an officer or authorized agent must be obtained for each of the California reporting entities. Also, print the name and title of the officer or authorized agent who signed the form on behalf of the California reporting entity.

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8) This authorization must be dated and signed by the principle officer (president, vice-president, secretary, treasurer, secretary-treasurer) or by a duly authorized agent of the designated corporation.
9) The telephone number, name and title of the person signing for the designated corporation must be entered.

***Note:***
By submitting Schedule R-7 of Form 100 the taxpayer is indicating election to file a single return for the entities included in the combined report.

**MEMBERS NOT INCLUDED IN THE AUTHORIZATION FOR SINGLE NOTICES**

**Members with Different Accounting Periods:** Because of statutory filing requirements, corporations having different accounting periods may not be included in the authorization for single billings. In these instances separate notices are issued.

**Part-Year Members:** Have there been reorganizations, liquidations, or changes in ownership? Corporations that become a member of the unitary group after the beginning of the taxable year or cease to be a member of the unitary group during the taxable year may not be included in the authorization for single billings. For example, if a California reporting corporation is a member of a combined group for only the first six months, a separate notice must be issued with the first six months of operations determined by combined report procedures and income for the last six months determined by separate accounting. See APR 83-3, 85-3, 85-5, 85-6, and 88-1.

**Bankrupt Members:** Separate notices should be issued in bankruptcy cases. The court may not recognize the single notice authorization. The key company may have no assets. Unitary affiliates may not be in bankruptcy or may have assets for payments to creditors.

**Suspended Members:** Suspended corporations do not have the right to file protests or claims for refund. Therefore, separate NPAs should be issued to suspended corporations so that the assessments can be allowed to go final.

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## 7090 RUSH ACTION SLIP (FORM FTB 7011)

* * * *

## 7110 THE ABATEMENT/REFUND MEMO (FORM FTB 6163)

This form is available in the * * * * * * * * * * * * * * * * * * * *. The auditor shall complete form FTB 6163 in the following manner:

1. TO: enter "Multistate Audit Program Bureau."
2. FROM: enter the appropriate Multistate Audit Program.
3. RE: enter the taxpayer's name.
4. CORP NO: enter the taxpayer's corporation number.
5. TAXABLE YEAR(S): enter each taxable year for which an abatement/refund is being issued.
6. ABATEMENT/OVERPAYMENT AMOUNT: enter the amount of change in tax and penalty per taxable year. Enter the amount in parenthesis.
7. BASIS: include a brief explanation why the amount is being refunded.
8. STATUTE: enter the earliest statute of limitations date. ***This section must be completed.***

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## 7120 SUPPLEMENTAL ASSESSMENTS (FORM FTB 6213A AND/OR FORM FTB 5903)

Form FTB 5903 (Bank and Corporation Tax Supplemental Assessment) is used by Multistate Audit Technical Resource Section to assess Domestic Disclosure Spreadsheet (DDS) penalties. This applies to taxable years beginning before December 31, 1993 (for water's-edge cases involving entities that failed to comply with the DDS filing requirement).

Form FTB 6213A (Accounting Instructions/Corp) is used for all other account adjustments. This form can be used to request most adjustments the auditor requires by checking the appropriate boxes provided or writing instructions on the "Other" line. The form is available on PASS. * * *

3. To issue a refund based on an amended return that is not a formal claim, the auditor must:
   - Follow the procedure to cancel tax above. This will create the required credit.
   - Use the paragraph number 60000.
4. To issue a credit balance refund to clean up an taxable year, the auditor should:
   - Determine that the credit is legitimate. If the auditor is unsure, the case may be referred to BES Audit Technical Support for analysis.
   - Once the correct credit is determined, mark the Refund box.
   - Write "Balance" on the Amount line.
   - Use the paragraph number 60004.
5. To deny an "informal" claim for refund the auditor should:
   - Mark the Denial box.
   - Use the paragraph number 60001.
   - Include a written explanation.
6. To transfer credits between taxable years and corporations:
   - Mark the Transfer box.
   - Fill in the corporation number, years, and amounts in the boxes provided. Initial and date the form.
   - Staple the form to the corporation folder and route to BES Audit Technical Support for action.
   - If the auditor does not have the folder a "dummy" folder should be made.
   - * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

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## 7130 CORPORATION MEMORANDUM OF REMITTANCE (FORM FTB 6352)

### INSTRUCTIONS FOR COMPLETING FORM FTB 6352:

1. Name of entity for which the payment is made.
2. BETS code identifying the type of number used for the entity ID. (Most common is "*" for corporations.
3. Entity ID. (Most common is a * * * * * number for corporations.)
4. Date payment is first received by FTB. (This is the date received by receiving section.)
5. Total amount of payment.
6. 2-digit code for the account type on which the payment is to post. The most common are:
   - "*" for a B&C account or
   - "*" for a NB&C account. Used when a payment is for an NPA that has not yet been issued or for an NPA that has been issued but has not yet gone final.
7. Taxable year is the last day of the taxable year for which the payment is made.
8. Enter the total amount to be posted to on the account type and taxable year identified.
9. Enter your payroll unit, number and initials.

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## 7140 NOTICE OF ACTION / REVISION

**Notice Of Action / Notice Of Revision**
Notices of Action (NOA) and Notices of Revision (NOR) are prepared using the Notice of Proposed Assessment (NPA) (FTB 5830) [or the Notice of Action (NOA) (FTB 5931) in the case of needing to issue an NOA which supercedes the original NOA due to an error, etc.] as a worksheet following the instructions provided below. All changes to the figures and text should be made on the NPA or NOA in red pencil as follows:

1. In the upper right hand margin of the NPA or NOA, write in red the following three lines:
   - The type of notice to be mailed. Write "NOA-A", "NOA-W" or "NOA-R" for a Notice of Action or write "NOR-W" or "NOR-R" for a Notice of Revision. (Note: An NOR cannot be affirmed.) If a memo/do not mail Notice of Action is being prepared, write "Memo-Do Not Mail" above the notice type.
   - The next line should indicate your unit number and your initials.
   - The last line should be the date of your action.
2. Verify that the NPA address is current by writing "OK" in red next to it. If the address is not current, update it by crossing it out and writing the new address.
3. When an item of adjustment on the original NPA is unchanged the original explanation is to be deleted. Bracket the portion of text to be deleted in the left margin and write "out."
4. When an adjustment is eliminated entirely, bracket the portion of text to be deleted in the left margin and write "out." In addition, draw a line through the amount to be deleted in the adjustment column.
5. When an adjustment amount is modified, draw a line through the amount being changed and write the correct amount to the side, above, or below it, as is convenient and clear, and revise the explanation as required. When an item has been revised but the explanation still applies, indicate by noting "OK to type" at the left side of the explanation.
6. When a new item is introduced, write in the adjustment and add a paragraph of explanation. Note that an NOA cannot increase the tax above the original NPA tax. Refer to ABPS 99-3 for guidance on raising new issues at protest. It may be necessary in such cases to issue a new NPA in order to allow the taxpayer their protest rights.
7. The notice must clearly explain the basis for the adjustments regardless if the taxpayer agrees or disagrees with the action being taken. It is acceptable to refer to a position letter.

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8. The listing of credits available on applicable taxable years is mandatory on NOAs and NORs. The taxpayer's account must be reviewed for applicable credits/payments at the time of final action on the protest. Add a paragraph to the NPA or NOA acknowledging the payment(s) (i.e. ¶50699 or ¶50702).

9. If a memo-do not mail notice is being issued, add a paragraph explaining the reason.

10. If a carbon copy (cc) of the notice needs to be sent, at the bottom of the NPA or NOA write: "cc:", the name and address then circle the information. This makes the cc:, name and address stand out from the text of the notice.

11. For manual notices, FTB 6031 (blue flag) (for NOAs) or FTB 6031A (gold flag) (for NORs) is always affixed to the underside of the lower right side of the NPA or NOA in such a manner that it will not cover any material to be typed and so that it extends over the edge approximately one inch. If the NPA is for a water's edge election fee, an FTB 6094 (pink flag) is used instead of the FTB 6031 (blue flag).

12. Revenue data will be accumulated by the Revenue and Cost Clerk from the audit copy of Form FTB 5830 and Form FTB 5932. It will, therefore, be necessary to type the revenue code from the NPA being revised

In most cases, the NOA or NOR can then be entered into BETS (see MAPM 16140 - MAPM 16190). The degree to which the above steps are completed for cases which will be processed using BETS may depend upon unit procedures. However, certain situations will require manual rather than BETS processing. MAPM 16200 provides a list of situations for which manual processing is required. Once the steps above are completed the case will be ready for manual processing.

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## 8000 INTEREST & PENALTIES

MAPM 8010 Summary Of Penalties
MAPM 8020 Delinquent Penalty (Section 19131)
MAPM 8030 Reasonable Cause For Waiving Delinquency Penalty
MAPM 8040 Penalty For Failure To Furnish Information/File On Demand (Section 19133)
MAPM 8050 Reasonable Cause For Waiving Penalty For Failure To Furnish Information/File On Demand
MAPM 8060 Negligence Penalty (Section 25934-35 -A Repealed In 1990)
MAPM 8070 Accuracy-Related Penalty (Section 19164)
MAPM 8080 Exceptions To Accuracy-Related Penalty
MAPM 8085 Fraud (Section 19164(c))
MAPM 8100 Failure To File Annual Statement (SOS Penalty Section 19141)
MAPM 8110 Underpayment Penalty (Section 19132)
MAPM 8120 Underpayment Of Estimated Tax (Section 19142)
MAPM 8130 Interest
MAPM 8140 Interest Abatement

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## 8010 SUMMARY OF PENALTIES

The California Revenue and Taxation Code contain numerous provisions for the assessment of penalties in various situations where taxpayers have failed to comply with the law. Among these provisions are penalties for delinquent filing, underpayment of estimated taxes, failure to furnish information/returns, and failure to file. There are also provisions for waiving penalties under certain circumstances.

It is the auditor's responsibility to be familiar with the penalty sections of the law and to apply them uniformly.

Effective January 1, 2002, where penalties are being assessed, Revenue & Taxation Code Section 19187(b)(1) requires that the imposition of the penalty is personally approved in writing by the immediate supervisor of the individual making that determination or a higher level designated official.

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## 8020 DELINQUENT PENALTY (SECTION 19131)

The delinquent penalty is assessed on any corporation that fails to file a return on or before the due date or extended due date. The penalty is assessed on the net amount of the tax due on the return.

### APPLICATION

The penalty is assessed at the rate of 5 percent of the tax for each month, or a fraction of a month, elapsing between the due date of the return (determined without regard to any extension of time for filing) and the date on which filed, but the total penalty shall not exceed 25 percent of the tax. In the case of a commencing corporation, the penalty shall apply to all tax accruable on the due date of the return.

The delinquent penalty may be increased or decreased based on adjustments to tax after the original return is filed.

* *
* * * * * * * * *, to determine the due date of the return and the date it was filed.

### WAIVER

This penalty can be waived if the corporation submits a written statement listing the facts which support reasonable cause for failing to file the return by the original due date. (See **MAPM 8030**)

### EXCEPTION

This penalty should not be assessed if an underpayment penalty is being assessed which results in a larger penalty. (See **MAPM 8110** for the underpayment penalty.)

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## 8030 REASONABLE CAUSE FOR THE WAIVING DELINQUENCY PENALTY

The delinquency penalty is assessed unless there is reasonable cause and no willful neglect.

The following acceptable/unacceptable reasons are intended to be used as a guideline for purposes of uniform treatment and clarification. Auditors will continue to use their judgment in borderline and exceptional cases and, if necessary, should refer the matter to their supervisor or other designated reviewer.

Generally, information submitted by the taxpayer for reasonable cause will be acceptable in letter form; but, in cases of doubt or where evidence of mailing is required, an affidavit should be requested setting forth reasons for late filing.

### GENERALLY ACCEPTABLE REASONS:

- Death, or severe illness of the officer, or qualified representative or employee responsible for submitting or completing the return.
- California return sent on time to the Director of the Internal Revenue Service.
- Request for exemption is in process.
- Records are in litigation.

### GENERALLY UNACCEPTABLE REASONS:

- Confusion of the due date because of the State income tax filing date.
- Belief that a return was not required because of inactivity or operation at a loss.
- Payment of the tax by the due date but failure to file a return.
- Thought the corporation was exempt or dissolved.
- Failure to receive forms because of change of address or otherwise.
- Change of fiscal year caused filing of delinquent return.
- Confusion as to the correct incorporation date.

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- Lack of funds to pay the tax.

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## 8040 PENALTY FOR FAILURE TO FURNISH INFORMATION/FILE ON DEMAND (SECTION 19133)

When the taxpayers and representatives fail or refuse to furnish information requested in an audit (**MAPM 5030**), a formal demand for information should be served. This is appropriate when a response to a request for information is unreasonably delayed, incomplete, refused or ignored.

It is essential that auditors reevaluate the relevance and need for any missing information before making a formal demand. Has the relevance of the request been verbally discussed with the taxpayer? Is the request reasonable? Has the information already been provided but in some alternative format? Are other alternatives available? Is the representative's failure to provide the requested information due to reasonable cause?

If a demand is necessary, the formal demand must make reference to the unanswered request, the specific information requested and the necessity for the information. Reference must also be made to the imposition of the failure to furnish information penalty under R&TC §19133.

The failure to furnish information penalty should be assessed in cases where the formal demand is refused or ignored. The penalty is to be applied uniformly where (1) the information has been clearly requested in writing along with an explanation of the need for and relevance of the information, and (2) a formal demand has been served.

If the audit requests are not documented or the appropriate request and demand for information have not been made, any recommendations to assess the penalty based on a lack of taxpayer cooperation or refusal to furnish information will not be accepted.

Effective 1/1/2002, the immediate supervisor's approval is required anytime a failure to furnish information penalty is assessed. For significant audits including the Fortune 500 or other large audits, the supervisor may want to keep the program manager informed.

### APPLICATION

The penalty for failure to furnish information is 25% of the deficiency imposed that relates to the requested information. The penalty for failure to file on demand is 25% on the lesser of the assessment, without regard to refundable credits, or the tax shown on the return when filed.

### WAIVER

This penalty can be waived if the corporation submits a written statement listing the facts that support

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reasonable cause for failing to file a return upon notice and demand. (See **MAPM 8050** for more information.)

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## 8050 REASONABLE CAUSE FOR WAIVING THE PENALTY FOR FAILURE TO FURNISH INFORMATION ON DEMAND/FILE ON DEMAND

In order to waive the penalty, the taxpayer or representative must show that the failure is due to reasonable cause and not willful neglect. The following items are intended as a guide for purposes of uniform treatment and clarification. Auditors must use their judgment in borderline and exceptional cases and, if necessary, should refer the matter to their supervisor or other designated reviewer.

### GENERALLY ACCEPTABLE REASONS:

- When the representative is able to furnish evidence that the notice and demand was not received; however, an unsupported statement by the representatives that they did not receive the notice and demand will generally not be considered a reason for waiving the penalty.
- Where special circumstances make imposition of the penalty clearly inequitable.
- The destruction or impounding of records so that a return cannot be prepared and filed.
- Erroneous written advice by a representative of FTB.

Similar circumstances that warrant waiving penalties may be considered in this category. However, undue delay after a taxpayer has been contacted may not be considered as reasonable cause.

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## 8060 NEGLIGENCE PENALTY (SECTION 25934-35 -A REPEALED IN 1990)

The negligence penalty became the accuracy-related penalty under R&TC Section 19164 and IRC Section 6662 for taxable years beginning on or after January 1, 1990, and any other taxable year for which an assessment is made after the enactment date of July 16,1991.

See **MAPM 8070** for the Accuracy-Related Penalty.

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## 8070 ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX (SECTION 19164)

California Revenue & Tax Code Section 19164 provides that the accuracy-related penalty is imposed on the portion of any underpayment of tax required to be shown on the return attributable to any of the following:

- Negligence
- Substantial understatement of tax
- Substantial valuation misstatement, or
- Substantial overstatement of pension liabilities.

* * * * * * * * * * * * * * * * * * * *

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## 8080 EXCEPTIONS TO THE ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX

The most common reason for imposing an accuracy-related penalty is for substantial understatement of tax. Before the auditor assesses the penalty, the amount of the understatement must be reduced by any portion of the understatement to which any of the following apply:

- There is "substantial authority" for the treatment claimed. This standard is met if the weight of the authorities supporting the tax treatment of an item is "substantial" in relation to the weight of the authorities supporting contrary treatment. The types of authorities that should be considered, and the relative weight to give to those authorities is described in Treasury Regulation Section 1.6662-4(d).
- The relevant facts affecting the item's tax treatment are adequately disclosed in the return. Generally, such disclosure must be made on Federal Form 8275 or 8275-R attached to a return, or on a qualified amended return filed in accordance with the instructions in FTB Notice 1992-9 and FTB Notice 1992-12. Disclosure will not prevent imposition of the penalty if the tax treatment on the return is frivolous. (Treasury Regulation Section 1.6662-4(e), (f).)
- The regulations indicate that the most important factor to consider is the extent of the taxpayer's effort to report the proper tax liability and whether the taxpayer acted with reasonable cause or in good faith. An honest misunderstanding of fact or law that is reasonable in light of the experience and knowledge of the taxpayer may satisfy the reasonable cause/good faith exception. Isolated computational or transcriptional errors are also not inconsistent with reasonable cause and good faith. Reliance on an erroneous information return, professional advice, or other facts may satisfy the exception if such reliance was reasonable under the circumstances. (Treasury Regulation Section 1.6664-4(b).)

If it appears that the imposition of an accuracy-related penalty for substantial understatement may be appropriate, the taxpayer should be advised of the exception and given an opportunity to present substantial authority or explain why reasonable cause is present.

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## 8085 FRAUD (SECTION 19164(C))

If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. The fraud penalty shall be determined in accordance with the provisions of IRC Section 6663.

If any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment that the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

Where the fraud penalty is assessed in a federal audit report, it may be proposed on a Notice of Proposed Assessment. However, it must be independently supported by facts, as the State carries the burden of proof as to its correctness**. The definition of fraud is the intent to evade tax.**

An auditor is required to obtain the approval of the unit supervisor when:

- The fraud penalty is imposed without prior federal action
- The fraud penalty was added for federal purposes and our adjustment is based upon the RAR, but the fraud penalty is not being imposed.

The penalty can be abated only if the corporation substantiates in writing that there was no intent to evade tax.

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## 8100 FAILURE TO FILE ANNUAL STATEMENT (SOS PENALTY SECTION 19141)

Corporations are required to file an annual statement identifying its officers (Form SS100) with the Secretary of State.

If the officers fail to file an annual statement for two consecutive years, the following actions are taken:

- The Secretary of State (SOS) notifies the corporation of the possibility of suspension if a statement is not filed within 60 days.
- SOS suspends the corporation if the corporation does not comply within the 60 days.
- SOS notifies the FTB that the corporation is suspended. No penalty is yet assessed.
- FTB assesses the penalty against the corporation and sends the billing.
- The penalty amounts are $250 for general and all foreign corporations, and $50 for domestic nonprofit corporations.
- Interest is not charged on the penalty.

As a condition of revivor, a suspended corporation must furnish proof that the officer statement was filed with the SOS. The FTB is only the collection agency for this penalty. It does not have the authority to cancel or waive the penalty unless notified to do so by the SOS.

Questions regarding the assessment should be directed to the Office of Secretary of State, telephone number (916) 657-3537.

Taxpayers may access the Secretary of State via Internet at http://www.ss.ca.gov/

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## 8110 UNDERPAYMENT PENALTY (SECTION 19132)

The underpayment penalty is assessed if a corporation fails to pay the amount of the tax due by the original return due date. The automatic seven-month extension of time to file a return is not an extension of time to pay the tax due.

The underpayment penalty will not be assessed if ALL of the following requirements are met:

- An extension of time to file has been granted.
- At least 90% of the tax due is timely paid by the original return due date.
- The remainder of the tax due is paid by the extended due date.

The underpayment is 5% of the unpaid tax due on the original return due date, plus .05% per month of the remaining tax, not to exceed 40 months during which the “remaining tax” is greater than zero. The aggregate amount of penalty imposed by this subdivision shall not exceed 25 percent of the total unpaid tax.

Once the underpayment penalty is assessed, it may be decreased in conjunction with any decrease in the assessed tax, but it may not be increased.

Note: This penalty is rarely assessed by an auditor, as it would normally be assessed by Central Office staff, when appropriate. An auditor may encounter the issue on a claim for refund, however.

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## 8120 UNDERPAYMENT OF ESTIMATED TAX (SECTION 19142)

A penalty is imposed on the underpayment of tax if an installment is not paid in the correct amount, or in a timely manner. The penalty is computed on the underpayment of estimated tax from the date of the payment to the earlier of the date of payment, or the original due date of the return.

The underpayment of estimated tax is the difference between the amount due for each installment of the estimated tax and the amount actually paid or credited on or before the due date of that installment. In the case of any underpayment of estimated tax, an addition to tax is imposed based on the interest rate, for the amount of underpayment, for the period of the underpayment.

This penalty is rarely assessed by an auditor, as it would normally be assessed by Central Office staff, when applicable.

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## 8130 INTEREST

The Franchise Tax Board computes the interest rate biannually.

Interest accruing after June 30, 1983 is compounded daily on:

- Unpaid tax
- Interest
- Certain penalties
- Unpaid water's-edge fees, when applicable.

Interest rates may be found on FTB Form 1138, Bank and Corporation Billing Information.

Generally, interest is computed as follows:

- For additional tax, interest is computed from the due date of the original return to the date paid.
- For additional water's-edge fees, interest is computed from the due date of the original return to the date paid.
- For delinquent and underpayment penalties and accuracy-related penalties, interest is computed from the due date of the return including extension.
- For all other penalties, interest is computed from the date of the notification, (the transaction date on the video) to the date paid.

### Additional 2% Interest

Effective January 1, 1992, C corporations may be subject to 2% additional interest on underpayments if the cumulative unpaid tax for the taxable period exceeds $100,000. To avoid the 2% additional interest, the corporation must pay the total underpayment amount within 30 days of notice. If assessed, the 2% additional interest will be computed on any unpaid amount for the taxable period.

Regarding the 2% additional interest, Revenue and Taxation Code Section 19521 conforms to Internal Revenue Code Section 6621 with modifications.

If the entire assessment is paid within 15 days of the original notification, no interest is charged from the notice date to the date of payment.

Overpayments are allowed interest from the date of the overpayment or the due date of the return, whichever is later, to a date that is within 30 days of the refund date. Interest is allowed on an originally filed return if the refund is not paid within 90 days of the filed date.

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Erroneous refund interest is charged from 30 days after the taxpayer is notified of the erroneous refund to the date the money is repaid. If the refund check is returned uncashed, no interest accrues.

## THE AVON EXCEPTION

Every employee is responsible for being aware of the interest provisions affected by the federal court case, Avon Products, Inc. v. United States, 588 F. 342 (Avon), and insuring that accounts are corrected if the interest calculation results in a significant difference (* * *).

Generally, interest on the additional tax is assessed from the original due date of the return. The Avon Decision affects the interest starting date on the additional tax to the extent of an overpayment on the original timely or delinquent return if the overpayment was refunded or credited without interest, e.g., the refund or credit was made within 90 days after the return was filed or deemed filed.

Interest may not accrue on the additional tax, to the extent of the overpayment, for the period of time FTB held the overpayment and did not allow interest on the refund or credit.

When furnishing interest computations to taxpayers or when finalizing fully paid NPAs, it must be determined whether Avon applies.

Avon applies when all of the following are met:

- The additional tax is the result of an amended return or an NPA,
- There was an overpayment on the original return, and
- The overpayment was refunded or credited over to another year without interest allowed.

If Avon applies, interest is computed on the additional tax up to the amount of the overpayment starting from the date the overpayment was refunded or credited (use the account transaction date of the refund or credit). Interest is computed on the additional tax in excess of the overpayment from the original return due date.

If Avon applies, requests for interest calculations, account adjustments, and/or review of interest calculations may be made from Technical Support.

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## 8140 INTEREST ABATEMENT

Revenue and Taxation Code Section 19104(c) allows the Franchise Tax Board to abate all or any part of the assessed interest in certain cases. In order for interest to be abated, there must be a ministerial act on the part of FTB, which contributed to, or caused, the taxpayer to owe more interest than normal. For taxable or taxable years beginning on or after January 1, 1998, interest may also be abated when there is an unreasonable error or delay by an officer or employee of the Franchise Tax Board in performing a ministerial act.

**FOR INTEREST ABATEMENT REQUESTED BY THE TAXPAYER**:

If a taxpayer requests abatement of interest, the taxpayer must complete form FTB 3701 and return it to the Taxpayer's Advocate Office.

Before a taxpayer's request for interest abatement can be made, the assessment must be due and payable (in billable status) and not merely a proposed deficiency assessment (pending, protest, or appeal status).

**FOR INTEREST ABATEMENT INITIATED BY AN AUDITOR**:

Discuss any possible interest waiver cases with your supervisor. If you believe the taxpayer is entitled to have a portion of the interest owed waived, refer the case to the Interest Abatement Coordinator. Include a memo stating the facts and circumstances of the case and your suggested recommendation.

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## 9000 STATUTE OF LIMITATIONS

MAPM 9010 Statute Of Limitations - In General
MAPM 9020 Special Statute
MAPM 9030 Statute Of Limitation Chart
MAPM 9035 Eight-Year Statute of Limitations for Tax Shelters
MAPM 9040 Offset Of Barred Refund
MAPM 9045 Recovery of Erroneous Refunds
MAPM 9050 Securing State Waivers
MAPM 9060 Waiver For Former Members Of A Combined Report
MAPM 9070 Waivers For Corporate Groups In Diverse Business Activities
MAPM 9080 Facsimile (Fax) Waivers And Powers Of Attorney
MAPM 9090 Securing Waivers On Delinquent Returns
MAPM 9100 Federal Waiver
MAPM 9110 Procedures For Accepting Modified Waivers

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## 9010 STATUTE OF LIMITATIONS - IN GENERAL

The Statute of Limitations (SOL) is a time limit imposed by law on the right of both the state and the taxpayer to increase or decrease self-assessed taxes. There are several statutes involved governing various situations. (See the statute of limitations chart in **MAPM 9030**.) Special attention should be given to any recent legislative changes to the statute of limitations.

The auditor should avoid opening an audit within 6 to 12 months of the expiration of the statute of limitations. The department's practice is to use good judgment, taking into consideration the taxpayer's compliance history, revenue impact, estimated time for completion, etc.

Our program goal is to complete cases within 2 years of initial contact or 4 years of filing, or within a reasonable period as dictated by the circumstances of the case. In achieving that goal, the use of waivers should be minimized. This must be balanced with the goal of resolving cases at the lowest possible level and the inherent complicated nature of some major multistate and multinational audits.

**It is the auditor's responsibility to assure that the statute of limitations does not expire.** It is the auditor's responsibility to review each return immediately when assigned to determine the statute of limitations. The earliest statute date should be entered into PASS * * * * * * * * * * * * * * and the auditor's inventory report. The case should be reviewed on a monthly basis. If necessary, a waiver extending the statute of limitations should be obtained. The auditor should also look ahead to future open years not yet assigned to audit to ensure that the statute is maintained for these years as well.

The department shares with the taxpayer an obligation to conform to the law. Audit activities and recommendations must conform to the time frames prescribed by statute. With few exceptions, audits are to be completed well within the normal four-year period allowed by law for proposing deficiency assessments. * * * * * * * * * * * * * *

- An audit of earlier years is currently in process and the taxpayer does not wish to allow follow-up cycles to occur simultaneously, or FTB resource limitations exist.
- A federal audit is ongoing.
- There is a failure to adequately disclose information on the return.

Just as our work must be done in accordance with the statute of limitations, we are entitled to expect a reasonable degree of cooperation from taxpayers so that we can complete our work promptly. Taxpayers that are unable or unwilling to comply with legitimate audit requests cannot be allowed postponement just because they are "willing" to sign waivers; there must be a reasonable expectation on the part of the auditor that the necessary data will be forthcoming. If this is not the case, waivers are not a viable alternative. Uncooperative taxpayers should receive formal demands for information and, if necessary, penalties for failure to comply with these demands, within the normal SOL period.

For further details regarding penalties, see **MAPM 8000**.

**EXPLANATION OF THE STATUTE IN THE NARRATIVE REPORT:**

For any year being adjusted which the normal statute has expired, application of a special statute or type of extension (open state waiver, federal waiver, etc.) must be explained in the narrative. The explanation must include any dates upon which the statute is based, such as date of final determination of a federal change or date of the renegotiating payment. The statute date must be entered on FTB 6430 (**MAPM 7070**) and FTB 6833 (**MAPM 4040**).

Evidence of the open statute on any return is important particularly for the approval of a refund or credit or for consideration in a case in which a protest is filed on the grounds that the statute has expired.

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## 9020 SPECIAL STATUTE

In connection with any return for which the normal four-year SOL has expired, consideration should be given to applying any special statutes and securing waivers if such statute is soon to expire.

The auditor should be aware that while we cannot issue a Notice of Proposed Assessment on a year barred by statute, adjustments can be made on the barred year to revise any carryover (deductions and/or credits) claimed on an open year. (Rev. Rul. 56-285; Springfield Street Railway Co. v. U.S., 312 F.2d 754; State Farming Co., Inc. v. Comr., 40 T.C. 774 (1963).) Also see Multistate Audit Technique Manual **MATM 8080** (net operating losses) and **MATM 9010** (tax credits) for additional information.

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## 9030 STATUTE OF LIMITATION CHART

| Condition: | Notice of Proposed Assessment must be issued within: | Overassessment, Credit, Certification to the Board of Control, or Taxpayer Files within: |
|---|---|---|
| Normal | The later of 4 years after:<br>- The original due date (R&TC section19066), or<br>- The date the return was filed (R&TC section19057) | (For timely filed returns only), the later of:<br>- 4 years from the original due date,<br>- 4 years from date filed, or<br>- 1 year from date of overpayment.<br>(R&TC section 19306)<br><br>See **MAPM 9090** for statue of limitations on delinquent returns. |
| State Waiver | Period agreed upon (R&TC section19067) | Period agreed upon if refund was not barred when waiver was signed. (R&TC section19308) |
| Omission in excess of 25% of gross income | The later of 6 years after:<br>-The original due date (R&TC section19066), or<br>- The date the return was filed (R&TC section19058) | Not Applicable |
| Federal Waiver Signed | The later of:<br>- 4 years after the return was filed, or<br>- 6 months after the expiration of the federal waiver (R&TC section19065)<br>Also see **MAPM 9100** | The later of:<br>- 6 months after the expiration of the federal waiver, or<br>- The normal statute (R&TC section19308)<br>See Note 1 below. |
| Federal change (RAR or 1120x) reported by the taxpayer or IRS | 4 years after notification by either the TP or IRS (applicable for federal adjustments only) | The later of:<br>- 2 years from the date of the final federal determination, or |

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| **after** the specified period (6 months) See note 2 below | (R&TC section19060(b)) | - The normal statute (R&TC section19311) |
| Federal change (RAR or 1120x reported by the taxpayer or IRS **within** the specified period (6 months). See Note 1 below.<br><br>See also note 2 below | The later of:<br>- 2 years after notification by the taxpayer or IRS<br>- The normal statute<br><br>If an amended return or RAR is received, FTB has 2 years from the date received to issue an NPA.<br><br>(Applicable for federal adjustments only)<br>(R&TC section19059) | The later of:<br>- 2 years from the date of the final federal determination, or<br>- The normal statute (R&TC section19311) |
| TP and IRS fails to report a federal change (due to an RAR or the filing of a 1120X) | Anytime (there is no statute of limitations).<br>(R&TC section19060(a))<br>(Applicable for federal adjustments only) | The later of:<br>- The normal statute, or<br>- Two years from the date of the final federal determination.<br>(R&TC section19311) |
| Bad Debt Erroneous Inclusion of certain recoveries | Not applicable | 7 years from the due date of the return or the date filed (if timely)<br>(R&TC section19312) |
| Involuntary conversion (deficiency attributable to gain on conversion) | 4 years after notification by the taxpayer of replacement or intention not to replace.<br>(R&TC sections 24945 and 19061) | Not applicable |
| Involuntary conversion (deficiency attributable to other gain on conversion) | At any time before the expiration of the period within which a deficiency for the last taxable year may be assessed.<br>(R&TC section 24946) | Not applicable |
| Patronage Dividends (noncash dividends elected to | 4 years from the date the taxpayer notifies the department that gains from | Not applicable |

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| be excluded.) | noncash dividends are realized.<br>(R&TC section 24273.5(f)) | |
| Bankruptcy | Statute of limitations date is suspended for up to 2 years or 30 days after FTB receives notice. See **MAPM 14000** for Bankruptcy information.<br>(R&TC §19089) | Not applicable |
| Unreported installment income | Within 4 years after the taxpayer ceases to be subject to tax.<br>(R&TC section24672) | Not applicable |
| Abusive Tax Avoidance Transaction (ATAT) | Eight years after taxpayer files a return<br><br>Applicable for returns filed on or after January 1, 2000<br>(R&TC section 19755) | Not Applicable |
| TRANSFEREE | | |
| 1. Original Transferee | Within 1 year after the expiration of the normal statute<br>(R&TC section19074(a)) | Not applicable |
| 2. Transferee of Original Transferee | Within 1 year after the expiration of the period of limitations of the preceding transferee.<br>(R&TC section19074(b)) | Not applicable |
| 3. Other than transferee certain distributions pursuant to Bank Holding Company Act. | 5 years after distributing corporation notifies that the period prescribed in Section 4(a) of Bank Holding Company Act has expired. | Not applicable |
| Fraud, or no return filed | No limitation.<br>Civil assessment may be made at any time. | Not applicable. |

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**Note 1:** Protest and appeals to the Tax Court, Circuit Court, etc may extend the Federal waivers. This would extend the agreed period as follows - 90 days after the final decision to assess. The State would then have 6 months from this last date to make assessments or allow refunds.

**Note 2:** If an RAR or a 100x is included in a field audit file, the date the RAR or 100x was received should be stamped on the RAR or 100x.

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## 9035 EIGHT-YEAR STATUTE OF LIMITATIONS FOR TAX SHELTERS

Revenue and Taxation Code (R&TC) section 19755 allows the Franchise Tax Board (FTB) eight years after a taxpayer files a return to mail a proposed deficiency assessment relating to an abusive tax avoidance transaction (ATAT). This extended period is applicable for returns filed on or after January 1, 2000. For purposes of this section, ATAT is defined under R&TCsection19753(c) as "a plan or arrangement devised for the principal purpose of avoiding tax," including, but not limited to "listed transactions" as described in R&TC section 18407(a). (Also see chief Counsel Announcement 2003-1, Abusive Tax Shelters – California Listed Transactions.)

- For open or closed years where there is "some substantive evidence" (defined below) that tax benefits claimed relate to ATATs, the auditor can assert the eight-year statute of limitations (SOL). Auditors must obtain supervisor approval before opening otherwise closed years in reliance on R&TC section 19755.
- For open years where there is no substantive evidence that tax benefits claimed relate to ATATs, auditors should request waivers to extend the normal SOL rather than rely on R&TC section 19755. Auditors cannot rely on R&TC section 19755 to open otherwise closed years if there is no evidence that tax benefits claimed relate to ATATs.

To assert the eight-year statute of limitations, we must have some initial indication that tax benefits claimed relate to ATATs. However, the statutes do not provide any guidance on opening otherwise closed years where there is a potential deficiency related to an ATAT.

Administrative and judicial decisions involving nonfilers may provide guidance. In cases involving estimation of unreported income, the State Board of Equalization and courts have concluded that FTB has the initial burden of demonstrating that reconstruction of income is reasonable and rational. We need only to provide some substantive evidence linking the taxpayer with the unreported income. *(Appeal of Michael E. Myers,* 2001-SBE-001, May 31,2002; *Rapp. V. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) Once we have satisfied this burden, our determination is presumed correct and the taxpayer has the burden of proving it wrong. (*Todd v. McColgan* (1949) 89 Cal. App.2d 509.) Failure to provide information within the taxpayer's control give rise to a presumption that such evidence is unfavorable to the taxpayer's case. *(Appeal of Don A. Cookston,* 83-SBE-048, January 3, 1983.) In no case can FTB's determination of the deficiency be arbitrary or without foundation. (R&TC section 19033(a).)

Our initial burden is satisfied when we have obtained "some substantive evidence" or have "reasonable and rational" belief that tax benefits claimed relate to an ATAT. Once we have satisfied our initial burden of demonstrating that the proposed deficiency is related to an ATAT, the burden shifts to the taxpayer to establish that the proposed deficiency is not related to an ATAT. However, if

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the taxpayer is successful in meeting that burden, the proposed deficiency will be held invalid as not timely issued.

What constitutes "some substantive evidence" or "reasonable and rational" belief for cases involving potentially abusive tax avoidance transactions is subjective and will depend on the facts and circumstances of each case. "Some substantive evidence" might include information received from sources such as the IRS, promoters or other sources that indicates possible participation in a tax shelter. Such evidence might also include return information such as unusually large losses offsetting income, indication of movement of assets, sharp reduction in wages or other income as compared from one year to the next, significant changes in the apportionment factor as compared from one year to the next, etc. Information obtained from an audit of different years, or of related individuals or entities, may constitute "some substantive evidence" that the taxpayer participated in an ATAT.

Helpful Point:

The statutory definition of ATAT for purposes of asserting the eight-year SOL, includes transactions that constitute tax avoidance or aggressive tax planning, even though they may not be listed transactions or mass-marketed products. The definition provided under R&TC section 19753(c) provides that an ATAT is "a plan or arrangement devised for the principal purposes of avoiding tax," including "listed transactions" as described in R&TC section 18407(a). An item does not have to be the same as, or substantially similar to, a listed transaction in order to be an ATAT.

If the auditor has obtained "some substantive evidence" that tax benefits relate to an ATAT, a waiver is not required. For open years where the auditor has not obtained "some substantive evidence" that tax benefits claimed relate to ATATs, the auditor should request a waiver to extend the normal SOL rather than rely on the R&TC section 19755. The taxpayer may want to sigh a waiver that only extends the SOL for the ATAT. However, recall that, in general, auditors cannot accept modified waivers. (See Audit Branch Policy Statement 98-2, Acceptance of Modified Waivers.)

If the auditor has not obtained "some substantive evidence" that tax benefits claimed relate to ATATs the auditor cannot assert the eight-year SOL. The auditor may want to ascertain whether a federal waiver is in place or if the statute of limitations can be otherwise extended pursuant to R&TC section 19058 for omission of income. (See APR 96-2.)

If an auditor closes a case under an SOL extended by a waiver, but the waiver is ultimately determined to be invalid, the auditor can fall back on the eight-year statute of limitations if the potential deficiency relates to an ATAT.

If it is later determined that a deficiency proposed under the eight-year SOL does not relate to an ATAT as required by R&TC section 19755, the eight-year SOL will. The entire assessment would be invalid.

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An auditor can assert the eight-year statute of limitations even if evidence doesn't conclusively indicate that an item is related to an ATAT. If we have "some substantive evidence" or "reasonable and rational" belief that a case involves an ATAT, the burden is on the taxpayer to demonstrate that the suspect return position does not relate to an ATAT.

**Failure to Provide Information**

If the auditor has obtained "some substantive evidence" that tax benefits claimed relate to an ATAT, and the taxpayer refuses to provide information on the basis that suspected items are not related to an ATAT, the auditor should respond in a manner consistent with normal business practices (CCR section 19032) .The auditor should make a formal demand for information. If the demand goes unanswered, the auditor may issue an NPA assessing the penalty for failure to provide information upon notice and demand pursuant to R&TC section 19133 and any other applicable penalty (such as interest-based or understatement penalties). The auditor should also consider issuing subpoena duces tecum.

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## 9040 OFFSET OF BARRED REFUND

In the case of corporations, California Revenue and Taxation Code §19314, although not extending the statute of limitations for a claim for refund, permits an offset of a barred refund against a deficiency resulting from a transfer of items of income or deductions or both to or from another year for the same taxpayer, or for the same or different years if such items of income or deductions are transferred between affiliated taxpayers whose tax is determined based on combined reporting. The offset must be made within 7 years after the due date of the return on which the overpayment is determined.

In cases where the taxpayers are claiming overpayment pursuant to California Revenue and Taxation Code §19314 and the issues in question deal with straddle investments or tax shelters, the auditor should be aware of the following:

- If the straddles entered into were shams, then California Revenue and Taxation Code §19314 is inapplicable because there was never any item of income to report, let alone transfer; and
- If the straddles were disallowed because the transactions were not entered into for profit, then California Revenue and Taxation Code §19314 is inapplicable because the closing of each straddle transaction is considered a separate transaction. (Smith v. Commissioner, 78 T.C. 350 (1982).)

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## 9045 RECOVERY OF ERRONEOUS REFUNDS

Under California Revenue and Taxation Code §19411, action for recovery of erroneous refund or credit may be brought within 2 years after the refund or credit was made, or during the period within which the department may mail a Notice of Proposed Assessment, whichever period expires later.

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## 9050 SECURING STATE WAIVERS

To extend the normal statute for NPAs, refunds, or the six-month period after waiver of Federal normal statute, a waiver must be secured on form FTB 3570, Waiver Extending Statute of Limitations for Proposing Deficiency Assessments. The waivers must cover all California taxpayers. Either separate waivers or one waiver covering all corporations (attach list if necessary) must be obtained.

When a waiver has been obtained, it is the auditor's responsibility to have the SOL information updated on BETS and PASS.

Note: Under Regulation Section 19032, as soon as practicable after the return is filed, the Franchise Tax Board shall examine the return and determine the correct amount of the tax. Our program goal is to complete cases within 2 years of initial contact or 4 years from the date that the return was filed, or within a reasonable period as dictated by the circumstances of the case. Auditors should be requesting waivers only when warranted by circumstances of the case. Minimization of the issuance of waivers must be balanced with the goal of resolving cases at the lowest possible level and the inherent complexities of some major multistate and multinational audits.

The auditor must make an effort to secure a waiver when the statute will expire within six months:

* All waivers should, if possible, have an expiration date that is the same as the statute date on the subsequent year's return. This will minimize the number of odd statute dates to be controlled.
* The request for a waiver (Form FTB 3570) should not include the statement that the extension will extend the time for claiming a refund unless the period for claiming a refund has not yet expired.
* An appropriate follow-up date on the letter must be used. This is necessary to assure that a protective NPA can be issued in the event a signed waiver is not received prior to the statute expiration date.
* If a waiver cannot be secured for a short statute case, please provide an explanation on the workpapers and issue a protective NPA.
* The waiver should be attached to the return for the most current year it relates to and a photocopy of the waiver attached to each return the waiver relates to, regardless of whether an adjustment is being made. A copy of the waiver should also be included in the workpaper file. It is the auditor's responsibility to verify that the statute is open.

To be valid, the waiver must be signed and dated by a principal officer, duly authorized representative or agent, or by officials of the corporation who are charged with the management of its fiscal affairs, particularly with reference to the preparation of its income tax returns. Such officials would usually include the treasurer, secretary, tax director and tax manager. The waiver must indicate the title of the signer and be executed on or before the date the statute would otherwise expire.

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The Legal Division has determined that a waiver signed by a corporate official other than a principal officer (president, vice-president, secretary, treasurer, and secretary-treasurer) cannot be accepted unless such official has been duly authorized by the corporation to so act. Moreover, waivers signed by a representative or attorney-in-fact must be accompanied by a power of attorney authorizing such signature. The waiver must indicate the title of the signer and be executed on or before the date the statute would otherwise expire. Again, the auditor is required to make sure that the evidence attesting to such authorization is attached to the waiver, if not previously provided. However, where prior waivers have been signed and accepted in the past, waivers signed by other than a principal officer will continue to be accepted until the years under audit have been closed. A waiver obtained from a corporation where no previous waiver is in force must be signed by a principal corporate officer or authorized official as stated above.

Note: If a waiver is being signed by a representative who is the designee authorized in a power of attorney, the auditor should verify that the power of attorney has not expired. In such case, there must be a current, valid power of attorney existing at the time that the waiver is signed.

Occasionally, a situation will be encountered where the statute of limitations will expire prior to the time that the NPA or other notice would be completed under normal procedures. In these cases, the auditor will take the following action:

1. If the statute of limitations will expire within 90 days from the date the auditor completes his/her work on a proposed assessment, or overassessment, the auditor will complete form FTB 7011 (RUSH). (See **MAPM 7090** for instructions on completing the form)
2. The form FTB 7011 is placed on the front of the file when the file is given to the reviewer. The form FTB 7011 is to be attached to the face of the file on the outside of the folder.
3. Enter the date that the notice(s) is to be mailed. Whenever possible, the Support Section should have at least ten working days to complete the case before the specified mailing date on the form FTB 7011.
4. If the statute will expire within 15 working days, complete the form FTB 7011, check box labeled "Walk-Through". The case should be walked to the supervisor of the first section or unit, which must act next, on the case. The supervisor of each section or unit to which the case is delivered on a walk-through basis will be responsible for walking the case to the supervisor of the next unit in the order of delivery.

**CAUTION:**

Where the corporation has filed a timely claim, the statute is extended only for the amount claimed. The auditor should <u>always</u> request an extension (FTB 3570) to keep the statute open for the state. The supervisor should approve any exception to this. If the representative declines to sign a waiver

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consideration must be given to insisting that the examination be conducted while the statute is open or to issuing appropriate provisional assessments.

**WAIVER POLICY: 1992 AND SUBSEQUENT YEARS**

In 1992, the terms and conditions of the Schedule R-7 "*Election to File a Unitary Taxpayers' Group Return*" were revised to clarify that a state SOL waiver signed by the key corporation would be binding on all members electing to be included in the group return. Therefore, beginning with taxable years filed with the 1992 Schedule R-7, auditors may obtain blanket waivers for taxpayers that were included in the original Schedule R-7 group return. The taxpayer name on the waivers should be shown as "*(key corporation) and Schedule R-7 Electing Members*."

As long as a Schedule R-7 for 1992 or subsequent was executed, the blanket waiver will generally be acceptable even if the auditor is proposing to decombine the taxpayers or if one or more of the taxpayers have been sold. Judgment should be used of course -- if a taxpayer is asking to terminate their R-7 relationship, the auditor should obtain separate waivers to avoid potential problems. (Likewise, single notices can be mailed to taxpayers filing on a 1992 or subsequent Schedule R-7 regardless of whether a taxpayer has been decombined or sold, but the auditor should consider issuing separate notices if the taxpayer so requests.)

Separate waivers will be needed for taxpayers that did not file as part of the Schedule R-7 group return. If the audit includes returns from more than one R-7 group of corporations, the key corporation of each Sch. R-7 group must execute a separate waiver on behalf of that group.

**WAIVER POLICY: PRIOR TO 1992**

Prior to 1992, the terms of the Schedule R-7 did not include an express authorization by the taxpayers for the key corporation to sign waivers on their behalf. In order to avoid potential controversy, the department's waiver policy was revised to require auditors to obtain either separate waivers from each taxpayer in the combined report, or powers-of-attorney authorizing the corporation handling the audit to execute waivers on behalf of the other members. An exception to this policy is permitted if all of the following criteria are met:

- The audit is not expected to result in decombination; *and*
- All of the taxpayers are still affiliated with the key corporation; *and*
- The key corporation is a California taxpayer qualified with the Secretary of State; *and*
- The key corporation is financially stable, has substantial net assets to pay the affiliates' deficiencies, and has not shown any indication that they would be unwilling to pay the affiliates' portion of the tax; *and*
- The key corporation has acted in good faith in fulfilling its obligations to pay under the terms of the Schedule R-7 in the past (i.e., they have not tried to terminate an R-7 relationship, refused

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to pay the tax of a combined subsidiary, attempted to disregard a waiver executed on behalf of a subsidiary, etc.).

If all of the above criteria are met, the auditor may accept a blanket waiver signed by the key corporation on behalf of taxpayers included in the Schedule R-7 election. Separate waivers must still be obtained from any taxpayers that have been disaffiliated or are expected to be decombined. An explanation of how the above criteria were satisfied should be included in the audit narrative. Even if the above criteria applies, auditors should still consider obtaining separate waivers in cases where intrastate apportionment would result in a large potential tax liability being attributed to a taxpayer other than the key corporation.

**Note:** This policy applies to all pre-1992 taxable years with open SOLs, including years that are open under previously executed state waivers. However, for pre-1992 taxable years that are already under a blanket state waiver, the auditor may continue to accept a signature by the parent or key corporation on behalf of its affiliates. Although such waivers are still valid, if there is an open federal waiver the auditor should obtain separate state waivers in order to comply with the department's waiver policy.

Waivers should be signed by a principal officer (president, vice-president, secretary, treasurer, etc.) or duly authorized agent of the taxpayer. A tax manager is not often a principle officer, so before accepting a waiver signed by a tax manager (or other corporate official other than a principal officer), the auditor should obtain a power of attorney or other evidence that the corporation has duly authorized the official.

In lieu of repeatedly obtaining separate waivers from each taxpayer every time a SOL extension is needed, auditors may obtain a power of attorney from each taxpayer. If the taxpayers designate a common agent to sign the waivers, then single waivers can be obtained from that point onward. The FTB Form 3520 is a power of attorney form designed specifically for this purpose. If several taxpayers in a combined report have a principal officer or other authorized individual in common, then those taxpayers may use the form to execute a single power of attorney. In most cases, the appointee who is granted the authority to sign waivers should be the member of the combined report that is handling the audit.

## SUSPENDED CORPORATIONS

Although a waiver signed by a suspended corporation will be accepted by the department, there are risks involved, which would cause the waiver to be subject to voidability. Therefore, the auditor must ensure that the key corporation that signs the waiver on behalf of itself or a group is not suspended.

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## 9060 WAIVER FOR FORMER MEMBERS OF A COMBINED REPORT

Since 1992, taxpayers that make a Schedule R-7 election to file a group return agree that the key corporation will act as agent and surety on behalf of the other electing taxpayers. This gives the key corporation authority to sign waivers on behalf of affiliates included on the R-7. The Schedule R-7 authority continues to be valid for that taxable year even if the taxpayers are later disaffiliated unless the taxpayer informs the FTB that they are terminating the R-7 relationship. Because there are no instructions for how to terminate the R-7, it's appropriate to use some judgment to determine whether they want to terminate the R-7. But, if the key corporation has indicated that they are not on good terms with the sold subsidiaries and want them to be separately billed, then written confirmation must be obtained as to whether they wish to terminate the R-7 relationship.

When a federal waiver exists, the state SOL is extended under California Revenue and Taxation Code §19065. This provision applies even if the former parent on behalf of the subsidiary signed the federal waiver.

A principal corporate officer must sign a waiver when no previous waiver is in force. However, where prior waivers were signed and accepted in the past, waivers signed by other than a principal officer will continue to be accepted until the years under audit have been closed.

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## 9070 WAIVERS FOR CORPORATE GROUPS IN DIVERSE BUSINESS ACTIVITIES

Situations may occur where corporate groups are involved in diverse business operations. A group of subsidiaries of the grandparent may be unitary, but not with other affiliated segments. State law provides that a waiver is only valid with respect to entities in the combined group. For this reason, the waiver should indicate the grandparent's corporate name and state "and Schedule R-7 electing Subsidiaries".

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## 9080 FACSIMILE (FAX) WAIVERS AND POWERS OF ATTORNEY

A facsimile or photocopy is acceptable as evidence that the waiver or power of attorney has been signed. Our research indicates that the IRS now accepts fax copies of these documents. However, to avoid evidentiary problems if the authenticity is later questioned, auditors should attempt to obtain the actual document.

### POWERS OF ATTORNEY

In its 11/91 revision to Publication 947, Practice Before the IRS and Power of Attorney, the IRS announced that it will accept a copy of a power of attorney that is submitted by facsimile transmission.

### WAIVERS

California Revenue and Taxation Code §19067 is based on and substantially similar to Internal Revenue Code §6501(c)(4). As explained in Treas. Reg. §301.6501(c)-1(d), the extension becomes effective when the agreement has been executed by both parties; i.e., upon signature. There is no requirement in the statute that the waiver be mailed or transmitted to the Franchise Tax Board.

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## 9090 SECURING WAIVERS ON DELINQUENT RETURNS

**CAUTION:**

The normal statute for issuing Notices of Proposed Assessment for **delinquent** returns expires four years from the date filed. However, for issuing refunds, the statute expires four years from the due date of the return or one year from the date of payment, whichever is later. This, in effect, creates a "gap" between the SOL for refunds and deficiency notices. Therefore, the request for a waiver (form 3570) should not include the statement that the extension will extend the time for claiming a refund unless the period for claiming a refund has not yet expired. If necessary to request a waiver, auditors should request waivers that will keep the statute open for both assessments and refunds, when possible.

In the list at **MAPM 9030**, where "not applicable" is shown in the third column, the statute for filing a claim should not be extended.

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## 9100 FEDERAL WAIVER

If the normal state SOL has expired for any year and there appears to be a possible adjustment, the auditor should ascertain from the taxpayer or the taxpayer's representative whether there is a federal waiver. If the taxpayer claims there is no federal waiver, inquiry should be made as to whether a federal audit is in progress, whether a federal audit was completed, and whether an RAR was issued. If an RAR was issued, the auditor should ask the taxpayer whether any issues were protested. If an IRS audit is either in progress or if an RAR was issued which the taxpayer contested, a federal waiver will almost always be present. The IRS has two types of waivers:

Form 872 - provides specific taxpayer(s), taxable years and extended date

Form 872A - open-ended statute with no specific extended date

Taxpayers filing consolidated 1120's will have one Form 872 for the consolidated group. If there are two or more California qualified corporations in the group, the federal waiver would apply to all corporations in the group. The IRS uses form 872A for cases that have been appealed. The form precludes the need of keeping track of extended statute dates and provides that the IRS can issue a notice 90 days after final determination at the appeal level. Since the department does not coordinate extended statute dates with the IRS, the auditor should always try to secure a state waiver even though there is an existing federal waiver. If the taxpayer will not execute a state waiver, prompt action should be taken by the auditor to complete the case.

Note: If the auditor has reason to believe that a federal waiver might be present and the taxpayer is not being cooperative, the auditor should request an IRS BMF transcript. This transcript will disclose whether a federal waiver is present. To obtain an IRS BMF transcript, fill out an FTB 6227 and send it to the IRS Coordinator who is in the RAR Unit. The RAR Unit is within the Federal and State Special Audit Section. The mail stop is D-745.

The supervisor should always be kept informed of the *earliest* statute date. This is particularly important if an adjustment is being proposed and the normal statute is extended due to an existing Form 872 or 872A. There must be evidence in the file to substantiate that the statute is open before notices can be issued.

California Revenue and Taxation Code §19065 provides that the state SOL remains open for 6 months after the expiration of the federal waiver. The question arises as to whether the 6-month period begins to run on the stated expiration date of the federal waiver or the date of the earlier final federal determination. The current policy is that the SOL remains open for 6 months after the stated expiration date even if there has been an earlier final federal determination. However, to protect the state's interest, it is always best to issue the assessments within the 6 months of the final federal

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determination. If the 6-month period has passed before you discover that the final federal determination was reached, legal will still defend the assessment as long as it is issued within 6 months after the stated expiration date on the federal waiver. Based on this analysis, claims for refund should be considered timely if they are received within 6 months after the stated date on the federal waiver even if a final federal determination occurred prior to that date.

In all cases involving an overpayment, when the statute would have normally expired prior to the date the Claim for Refund was filed (or the date credit is allowed) but for the existence of a federal waiver, it will be the responsibility of the auditor to have the taxpayer submit a copy of the waiver document.

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## 9110 PROCEDURES FOR ACCEPTING MODIFIED WAIVERS

### DEFINITION OF MODIFIED WAIVERS

A modified waiver is any waiver that has been altered in any manner from that which was originally sent by the auditor to the taxpayer or representative. The following are examples of modifications.

- Alterations on the waiver form which change the extended statute date.
- Alterations to the waiver outlined in a cover letter and included with the signed waiver.
- Alterations on the waiver form which limit the applicability of the extended statute (i.e. to certain issues or dollar amounts).

### SPECIFIC PROCEDURES

The current policy is ***not*** to accept a modified waiver. Auditors must obtain an unaltered waiver or complete the case within the normal statute of limitations.

However, it is understood that there may be some factual circumstances where it may be in the state's best interest and the taxpayer's best interest to accept a waiver that limits the applicability of the extended statute. Therefore, in these limited situations, the auditor must follow the approval procedures outlined below prior to accepting a modified waiver.

1. The auditor will inform his/her supervisor that a modified waiver has been proposed and/or received which seeks to limit the applicability of the extended statute and discuss the reasons why the limitations should be accepted.

2. Once the auditor and supervisor agree that it is in everyone's best interest to accept the proposed limitations, the auditor will contact the appropriate Technical Resource Section (TRS) member, and provide:

- All facts, circumstances, and risks associated with accepting the modified waiver, and
- The basis and recommendation as to why the waiver should be accepted.

3. The TRS member will advise the auditor of whether or not the recommendation is appropriate. If it is appropriate, the TRS member will ensure the modified waiver contains the necessary language to sustain challenges of validity. The TRS member will use the facts and circumstances of each contact to monitor the policy for consistency and application of the exception rule.

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4. The auditor will complete a memorandum documenting the items as listed in Step #2 above and include all contacts with the taxpayer and TRS.

5. The memorandum will be signed and dated by the supervisor.

6. A copy of the signed and dated memorandum will be provided to the TRS member involved and the original will be kept in the case file.

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# 10000 CLAIMS, REFUNDS & OVERASSESSMENTS

MAPM 10010 Claims
MAPM 10020 Claims - Statute Of Limitations
MAPM 10030 Audit Procedures And Claim Recommendations
MAPM 10040 Refunds, Cancellations And Overassessments
MAPM 10050 Claims – RARs And Pending Federal
MAPM 10060 Offset Cases
MAPM 10070 Barred Offset - R&TC Section 19314
MAPM 10080 Abatement/Refund Of Tax And Penalties * * * * * * * * * * *
MAPM 10090 Erroneous Refund
MAPM 10100 Claims Control System
MAPM 10110 Appeals From Claim Denials – Procedures

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 10010 CLAIMS

Corporation claims for refund (claims) are processed through Business Entities Audit Technical Support (BES) and Multistate Audit (MSA). These two sections work closely together in managing the corporate claims workload to ensure that claims are resolved according to the Taxpayer Bill of Rights (TBOR) legislation enacted in 1988. According to R&TC Section 21010, the FTB is required to develop a plan to reduce the time required to resolve amended return claims for refund. The departmental plan establishes the following goals for resolving claims for refund:

- Goal for Claims Requiring Desk Audit Involvement = 12 months
- Goal for Claims Requiring Field Audit Involvement = 27 months

Additionally, another consideration when processing this workload is that in accordance with R&TC Section19331, a claim is “deemed denied” if the taxpayer is not mailed a notice of action on the claim within 6 months from the date the claim was filed. The following claims processing procedures are in place to assist the department in meeting the TBOR timeframes:

**Claims for refund may be filed via an amended return or written correspondence (correspondence claim). Currently amended returns are forwarded to the Claims Control Desk. Please see the following flow chart for a description of the process for incoming claims.**

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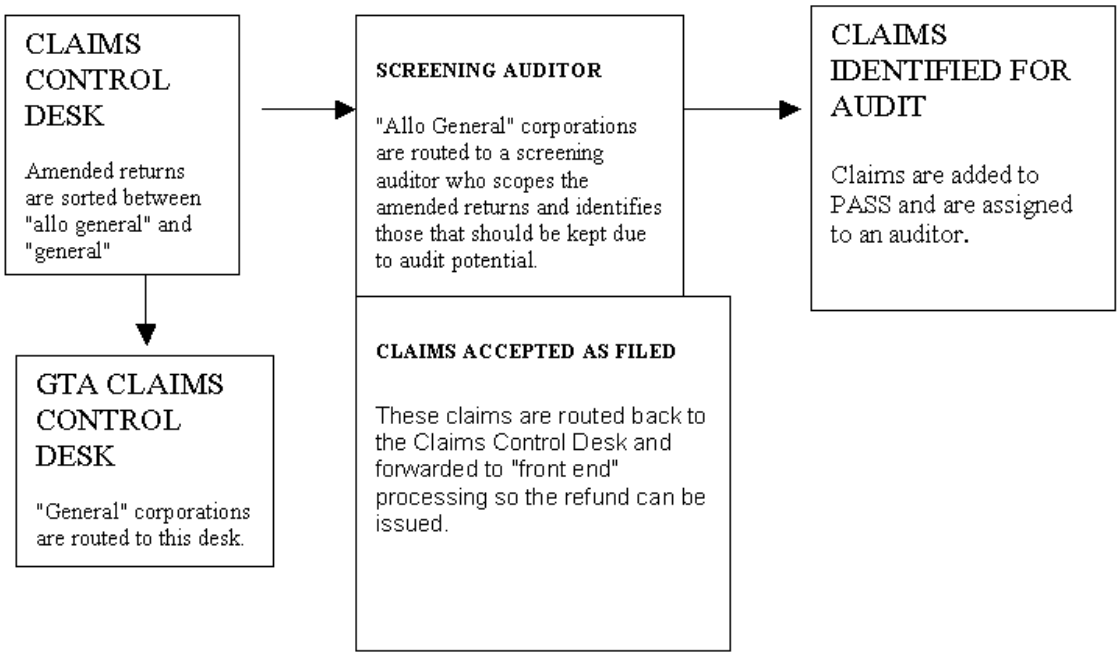
CLAIMS CONTROL DESK
Amended returns are sorted between "allo general" and "general"
SCREENING AUDITOR
"Allo General" corporations are routed to a screening auditor who scopes the amended returns and identifies those that should be kept due to audit potential.
CLAIMS IDENTIFIED FOR AUDIT
Claims are added to PASS and are assigned to an auditor.
GTA CLAIMS CONTROL DESK
"General" corporations are routed to this desk.
CLAIMS ACCEPTED AS FILED
These claims are routed back to the Claims Control Desk and forwarded to "front end" processing so the refund can be issued.

* * * *

E. Protective claim (usually denoted by $1 refund).

3) After the claims are screened through BETS, they are forwarded to an auditor for scoping purposes. * * *

(a) Be accompanied by written authorization from each taxpayer sought to be included in the class.
(b) Be signed by each taxpayer or taxpayer's authorized representative.
(c) State the specific grounds on which the claim is founded.

A claim for refund generally consists of written notification received from a taxpayer indicating an overpayment of tax. Claims come in a variety of forms. The following are examples of the most common types received by the department:

1) The filing of a completed or original return disclosing less tax than what was paid upon the filing of a tentative return including estimate payments and payments made with an extension of time to file.

2) A letter received from the taxpayer or representative indicating less tax due than what was paid.

3) Payment of a proposed assessment with or after the filing of a protest or appeal.

All apportioning corporations, general corporations that file combined reports and all non-qualified corporation (NQFT and NQIT) claims are referred to MSA Central Office for screening. Those meeting either field office or Central office audit criteria are retained and entered on to PASS for assignment to staff. The claims that do not meet audit criteria are accepted as filed and referred to BES for processing.

At times a taxpayer may file a claim for refund requesting $1 or more on a specific issue prior to the expiration of the statute of limitations and may write "Protective Claim" on the face of the claim for refund. The Revenue and Taxation Code does not expressly recognize a "protective claim for refund." However, the words "Protective Claim" are misleading since claims for refund requesting $1 or more stating the specific grounds upon which it is founded are valid "informal" claims for refund not "protective" claims for refund. A valid claim for refund must be in writing, must be signed by the taxpayer or the taxpayer's authorized representative, and must state the specific grounds upon which it is founded (R&TC section 19322). A claim for refund filed within the appropriate time frame must be considered a valid claim for refund. Pursuant to FTB Legal Ruling 386, "informal claims" toll the statute of limitations until the claim can be perfected. As long as the FTB is apprised of the fact that the taxpayer is asserting a claim for refund, the actual dollar amount shown, whether it be $1 or $100,000 is irrelevant.

When an "informal" claim for refund is received, the auditor needs to write a letter to the taxpayer to request further written clarification to "perfect" the claim. Upon receipt of appropriate documentation

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the correct refund amount is allowed. If the taxpayer does not provide adequate documentation to support the issue for which the refund is requested, the claim for refund is denied.

* * * *

Claims received at Central Office relating to an original return that is located at an FTB field office will be forwarded to that field office for action and possible resolution. If that office determines that the claim is not worthy of a field audit, the claim must be returned to the Claims Control Desk for possible assignment to a desk auditor for resolution. The field should return only those claims that can effectively be resolved by MSA Desk Unit.

**NOTE TO FIELD AUDITORS:**

**a. If the auditor receives an amended return, Form 100X**

When a field auditor receives an amended return from the taxpayer requesting a claim for refund, the following steps must be taken:

a) VERY IMPORTANT: The amended return must be date stamped upon receipt (reflect the actual received date on top of the amended return) to prevent problems with the statute of limitations.
b) Create a case unit in PASS or add a case unit to an existing PASS audit file.* * * * * * * * * * * * * * * * * * * * * * * * * * * *
c) Make a copy of the amended return for your records and write "COPY" in red.
d) Route the original amended return to the Claims Control Desk in MSA Central Office, * * * * * * * Attach a cover sheet:
   - Stating the Form 100x needs to be processed.
   - Include any needed instructions, any account notes that may need to be performed, or any special needs.
   - Indicate whether the claim should be returned to the field office. If so, indicate the mail stop and to who's attention.
e) The Claims Control Desk will make sure the amended return receives a DLN and is added to BETS, * * * * * * * * *
f) When a DLN has been assigned to the amended return, the Claims Control Desk will update the DLN on the PASS case unit and route the original amended return back to the field auditor.
g) When the field auditor receives the original return, the copy of the amended return can be destroyed.

**b. If the auditor receives correspondence claim for refund**

If you receive a correspondence claim for refund directly from the taxpayer, it must be date stamped. For a correspondence claim, you should:

1. Decide whether or not you will work it.

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2. If you decide to work the correspondence claim with your audit:
   - Keep it.
   - When your audit is completed, ensure the date and "CLAIM" is shown at the top of the correspondence claim.
3. Create a case unit in PASS or add a case unit to an existing PASS audit file. Use the same DLN as the original return.
4. If you do not work the claim:
   - Send it to the Claims Control Desk in MSA Central Office, Mail Stop D-12.
   - Attach a cover sheet stating the claim should be processed and assigned to be worked.

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## 10020 CLAIMS - STATUTE OF LIMITATIONS

The statute of limitations (SOL) for claims effective January 1, 2000, is generally the same as the SOL for deficiency assessments as long as the tax return was timely filed (**MAPM 9030**). The SOL for all open refund claims is determined as the later of the following dates:

1. Four years from the original due date of the return.
2. Four years from the date the return was filed (if filed by the due date or within the extension period).
3. One year from date of overpayment.

If the return was filed after the extended due date, item number 2 above does not apply and the SOL is determined by reference to the original due date of the return which is generally 2.5 months after the last day of the taxable year. This rule is different than the SOL rule for deficiency assessments since an NPA may be issued up to four years after the date the return was filed regardless of whether it was timely filed.

The law became effective on January 1, 2000, to any taxable year with an open statute on that date. It does not apply to re-open the SOL on a year in which the SOL has expired under the old law. Under the old law, the SOL for claims was determined as the later of the following dates:

1. Four years from the original due date of the return;
2. One year from date of overpayment.

RUSH REQUEST

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CLAIMS AND SOL

If a claim audit is started after the expiration of the SOL for issuing an NPA, the auditor may continue to pursue adjustments for audit issues as well as the claim issues to offset the claim. However, tax can be increased only to the extent of the claim.

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## 10030 AUDIT PROCEDURES AND CLAIM RECOMMENDATIONS

Follow these procedures when auditing a claim for refund:

1. Determine the taxpayer's status under BETS, * * * * * * * * *. If "suspended" or "forfeited" and the auditor has not started an audit, forward the claim for refund to the Claims Control Desk. The Claims Control Desk will contact the taxpayer. If taxpayer contact has been made, see your lead auditor. Check BETS conversations * * * * * * * * * to determine if there are other amended returns or activities that would affect the claim.

2. Check the year to which the claim for refund applies:
   a. Was the claim timely filed? Verify the statute of limitations. Is the statute of limitations open for issuing a refund?
   b. Verify the amount of the claim for refund.
   c. If the taxpayer has not paid the original tax return liability, a claim for refund cannot exist. However, the amended return should be analyzed to determine whether the original tax liability requires adjustment. Also, if "CORP CLAIM" was stamped on the claim, this will need to be removed and if a CLAIM case unit was created on PASS it must be changed to an AUDIT case unit. * * * * * * * * *

h. A decision to deny a claim must be supported with a proper analysis of the facts in conjunction with a correct application of the law and regulations.

i. * * *

e. * * *

e. * * *

d. * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

e. * * * * * * * * * * * * * * * * * * *

**CLAIM ISSUE ALLOWED BUT NPA IS ISSUED FOR THE SAME YEAR**

a. BES will include the appeal rights when the final claim denial is sent to the taxpayer. The reason for the denial is because even though we allowed the amount related to the issue reflected in the claim, a refund would not be generated to the taxpayer since the overpayment of tax will be applied to the NPA.

b. Complete FTB 6830BCT or BETS NPA (use appropriate notice). Complete FTB 6638 for a full denial. On the FTB 6638 include the following paragraph, "The refund is disallowed; however, credit for the claim for refund is reflected to the extent allowable in the Notice of Proposed Assessment, number _____ dated _____." On form* * * * * * * * * * * * * * * * * * * * * * * *

c. The claim denial will be held until the NPA is final. This allows the taxpayer the right to file a protest on the NPA, and depending on the outcome of the protest, the claim will either be allowed or denied. If the NPA is withdrawn the claim will be allowed, if the NPA is affirmed the claim will be denied. Final action on the claim is taken after the NPA goes final.

d. * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

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CLAIM DENIED IN FULL – Prepare PASS form FTB 6638, Auditors Recommendation Formal Claims worksheet (ARFC) (**MAPM 7050**). After Technical Resource Section (TRS) review, forward the file (PASS and paper) to BES for final processing.

CLAIM ALLOWED IN FULL – Prepare an ARFC worksheet (**MAPM 7050**). After TRS review, forward the file (PASS and paper) to BES for final processing.

CLAIM PARTIALLY DENIED – Prepare PASS form FTB 6830-BCT, NPA worksheet (**MAPM 7020**). Any cancellation is shown on this form as an overassessment. Include paragraph 50622.

CLAIM ALLOWED IN FULL **AND** ASSESSMENT ISSUED on the same year and the net result is an NPA – Prepare an NPA worksheet (**MAPM 7020**) and an ARFC worksheet (**MAPM 7050**) to deny the claim. Use paragraph 50625. A claim denial letter is sent when the NPA is finalized. This prevents the taxpayer from having to simultaneously protest the NPA and file an appeal with the State Board of Equalization for the denied claim.

CLAIM DENIED IN FULL **AND** NPA ISSUED for the same year – Prepare an NPA worksheet (**MAPM 7020**) and an ARFC worksheet (**MAPM 7050**).

CLAIM PARTIALLY DENIED **AND** AN NPA ISSUED on the same year - Follow the above instructions on ALLOWED IN FULL AND ASSESSMENT ISSUED.

TWO OR MORE CLAIMS ON THE SAME YEAR and one supersedes the other – Prepare an NPA worksheet (**MAPM 7020**) and an ARFC worksheet (**MAPM 7050**). Add a paragraph to the NPA worksheet informing the taxpayer the former claim was superseded by the latest claim filed. In the explanation section of the ARFC, instruct the Claims Control Desk * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * This allows the department to close the claim.

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Place the refund worksheet on top of the return, the Abatement/ Refund Memo on top of the refund worksheet and the Rush slip on top of these forms.

Place all worksheets on top of the file and forward the file (PASS and paper) to your reviewer.

8. Closing the Audit:

If audit work was performed on open returns for all years up to and including the claim year, initial all returns in the upper right-hand corner of the front page of each return.

9. * * * * * * * * * * * *

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a. * * * * * * * * * * * * * * * * * *
b. * * * * * * * * * * * * * * * * * * * * * * * * * * * * *
c. * * * * * * * * * * * * * * * * * * *

Note: Since the taxpayer is withdrawing the claim, it is **NOT** treated as a claim denial and the taxpayer does not receive appeal rights.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 10040 REFUNDS, CANCELLATIONS AND OVERASSESSMENTS

REFUNDS - The correct tax liability is less than the tax assessed and paid.

CANCELLATIONS (abatement) - The correct tax liability is less than the tax assessed.

OVERASSESSMENTS - Overassessments (O/A) generally result from an audit determination when tax on the return is overpaid.

Adjustments to income resulting in small refunds will not ordinarily be initiated, if there are questionable items on the return, which if disallowed, could possibly offset the adjustment. If the taxpayer requests or expects the adjustment, or consistency with our other actions is a factor, then the refund should be made.

The Claims Control Desk manages formal claims initiated by a taxpayer. Claims are generally filed on California form 100X. However, other written requests for refund can be treated as claims as though a form 100X was filed.

### REFUND/CANCELLATION SITUATIONS

The following are the most common types of refund/cancellation situations encountered by the department:

1. Audits that reduce tax and result in an overpayment.

2. Federal Audit Reports (RARs) received from the taxpayer.

3. Canceling or revising an NPA in billable status.

4. Credit balances on an account.

### COMPLETION OF FORMS - OVERASSESSMENTS

After an overassessment is determined, prepare a PASS form FTB 6830-BCT, NPA Worksheet **(MAPM 7020)**. After supervisor review, send the file (PASS and paper) to BES (desk) or Technical Resource Section (field) for processing according to the auditor's instructions. * * *

Complete PASS form FTB 6213A, Accounting Instructions/Corp. **(MAPM 7120)**, when an NPA is in billable status and tax is overassessed. BES will process the form.

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## 10050 CLAIMS – RARS AND PENDING FEDERAL

Claims - RAR

All apportioning corporation claims for refund (amended return and correspondence claims) containing RAR adjustments are referred to the Multistate Audit RAR Unit. Each amended return is reviewed to determine if the applicable California adjustments were made, if so the amended return is accepted as filed. If revisions are necessary, a notice of proposed assessment (NPA) or overassessment (O/A) reflecting the changes will be issued.

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## 10060 OFFSET CASES

### RELATED NPAS AND O/As

If all notices within a case are related and must be kept together in one package (previously referred to as a consent package), do the following:

1) Check the "Notice Related" box on each NPA and O/A worksheet (PASS form FTB 6830BCT).

2) Hold all NPAs and O/As for a period of 90 days (60-day protest period + 30-day processing).

3) If protest is not received within this timeframe offset O/As against NPAs and refund or bill remaining balance to the taxpayer.

4) If any NPA or O/A is protested, forward all notices to the Protest Unit for resolution.

### AUTHORIZED OFFSET WITH RELATED NPA AND O/A

If the audit is agreed, contains only related notices and written authorization was obtained from the taxpayer or representative to offset O/As against NPAs prior to expiration of the 60-day protest period, do the following:

1) Check the "Notice Related" box on each NPA and O/A worksheet.

2) Write "OFFSET" on each O/A worksheet indicating taxpayer's written authorization was received.

If BE Audit Technical Support determines a LARGE refund is due once the overpayment is computed, offset is performed immediately and refunded as soon as possible to reduce interest charges payable by the state.

If the related O/A will not result in a refund, the case will be held for 90 days.

NOTE: If the audit is unagreed, do not pursue an authorization to offset.

### NPA/O/As WITH UNRELATED OVERASSESSMENT NOTICES

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In the rare instance where an audit package contains unrelated O/As that should be refunded regardless of protest, do the following:

1) Check the "Notice Unrelated" box on the O/A to be processed (refunded) regardless of protest.

2) Check the "Notice Related" box on those notices (NPA or O/A that should remain together.

If the notice(s) are not protested, O/As will be offset against NPAs and any remaining balance will be refunded or billed to the taxpayer. If the related NPA and O/A are protested, the related NPA and O/A will be forwarded to the Protest Unit for resolution. The unrelated O/A will be refunded without offset.

Note: The unrelated notice is truly an exception to the rule. The purpose of an unrelated notice is to provide a means for issuing notices regardless of protest action on other notices. This should not occur often.

Example 1: RAR Received for an Taxable year End not in the Audit Cycle

As a result of an audit, NPAs are issued against TYE 12/90 and 12/91 with an O/A issued against TYE 12/92. The notices for all three years are "related". During the audit, the taxpayer inquires about an unrelated RAR refund in TYE 12/94. The auditor agrees to resolve the RAR. The 12/94 O/A is "unrelated". In preparing the worksheet, the auditor should check the “Notice Unrelated” box associated with TYE 12/94. If the related audit notices (TYE 12/90 – 92) are protested, the technician will send only the related audit notices to the Protest Unit for resolution. The unrelated RAR is processed separately.

Example 2: Issue is NOT Transactionally Related

Notices may be unrelated if the issues adjusted are not transactionally related, and there are *no* transactionally related issues being adjusted on the O/A.

For example, a bad debt is disallowed in one year, resulting in an NPA, and a business expense is increased in another year, resulting in an overassessment. There are no other common issues on the notices. These may be treated as unrelated notices.

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## 10070 BARRED OFFSET - SECTION 19314

California Revenue and Tax Code §19314 permits an offset of any barred overpayment that results from a transfer of items of income or deduction to or from another year for the same taxpayer or affiliated taxpayers whose tax is determined under Chapter 17 (commencing with R&TC §25101) of the Code. No offset shall be allowed after the expiration of seven years from the due date of the return on which the overpayment is determined (**MAPM 9040**).

### WORKSHEET FOR OFFSET ALLOWABLE (Use Form FTB 6830BCT)

1) Label the top of the form "Schedule I".

2) Line through the words "Additional Tax" and "Overassessment" and write "Offset Allowable, R&TC §19314".

3) Attach the worksheet to the outside of the folder behind the NPA worksheet on which the offset is being allowed.

### WORKSHEET FOR NPA (Use Form FTB 6830BCT)

1) On the Previously Assessed line, write "From Allowable Offset and Return."

2) In the column, enter the total of the allowable offset and the previously assessed tax per the return.

Cases involving more than one taxpayer require special attention to avoid unauthorized disclosure. If unauthorized disclosure becomes a concern on a given case, the computation of the offset should be mailed separately to the affected taxpayers. The offset on form FTB 6830BCT should be described as "Offset Allowable, §19314, from the return of _____."

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## 10080 ABATEMENT/REFUND OF TAX AND PENALTIES * * * * * * * * * *

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## 10090 ERRONEOUS REFUND

There are occasions when refunds are made in error, such as a refund sent to an incorrect address or an incorrect refund amount sent to the taxpayer. When an erroneous refund occurs, the department must send a letter to the taxpayer informing them of the situation and requesting a return of the refund. Information concerning the erroneous refund-accrued interest is usually sent along with the letter.

Process a billing cycle change to allow time for the taxpayer to return the erroneous refund. The interest allowed will be reversed. No interest is charged if the erroneous refund is repaid within 30 days of notification of the error. If refund is not repaid within 30 days, interest accrues from the date of the letter.

BE Audit Technical Support will enter the necessary transactions on BETS upon receiving the auditor's instructions for processing the erroneous refund. Use form FTB 6213A, Accounting Instructions/Corp.

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## 10100 CLAIMS CONTROL SYSTEM

The former Claims Control System, commonly referred to as BCCLR, was a recording and tracking mechanism for various corporation claims received by the department. As of July 1, 1999, the Claims Control Desk discontinued to update BCCLR. However, employees may continue to access the system for historical/research purposes. BETS and PASS are the current systems used to record and track claims. BETS * * * * * * * * * indicates years in which claims exist for a specific taxpayer. Detailed information regarding a claim is available on PASS. A find function may be used to locate PASS files.

The BCCLR display screen provides the following information:

| | | |
|---|---|---|
| 1 | Account Number | Corporation Number |
| 2 | XREF | Key Claim Number |
| 3 | Claim Year | Year of Claim. If more than one, separate screens for each. |
| 4 | Audit Code | "A" for Allocating General, "G" for General Corporation |
| 5 | Name | Corporation Name |
| 6 | Claim Amount | The amount the taxpayer is requesting as refund |
| 7 | $ Allowed/Denied | Amount of claim allowed or denied upon close-out |
| 8 | Disposition | "Blank" indicates an open case, "C/O" indicates closed case |
| 9 | Issue | Primary issue of the claim |
| 10 | Issue Codes | Issue code for the claim |
| 11 | Comment Section | Usually contains location information, associated taxpayers |
| 12 | Taxes Paid | Previously assessed tax |
| 13 | Date Claim received | Date the claim was received by FTB |
| 14 | Referred | Initials of the auditor to which the case was assigned |
| 15 | Date Referred | Date case was assigned to the auditor |
| 16 | Charged | Tracks location of the case (i.e., BE Audit Technical Support) |
| 17 | Date | Date the case was "charged" or sent out to a particular location |

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## 10110 APPEALS FROM CLAIM DENIALS – PROCEDURES

Once a claim for refund is denied, the taxpayer's next available option is to file an appeal with the State Board of Equalization (SBE). When the SBE decides a case, it sends a copy of its decision to Legal. Legal then sends a copy of the decision and appeal file to MSA Technical Resource Section (TRS) for analysis and processing purposes. TRS will review the decision and determine whether the department was sustained in its position or whether the taxpayer is due a refund.

- If the SBE sustained our position, insert the written SBE decision inside the first page of the return for the latest year appealed. Return any appeal folders included in the file to Legal. Return the taxpayer's files (i.e., tax returns and audit files) to Data Services.

- If the SBE did not sustain our position and the taxpayer is due a refund, route both the appeal folder and the taxpayer's files to the BE Audit Technical Support for the necessary action.

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## 11000 PROTEST & APPEAL

MAPM 11010 Recording A Protest
MAPM 11020 Protests & Appeals Process
MAPM 11030 Classification Of Protests
MAPM 11040 Docketed Protest
MAPM 11050 Undocketed Protest
MAPM 11060 Protests - Pending Federal (PF)
MAPM 11070 Protests - Field Audit
MAPM 11080 Requirements For Valid Protest
MAPM 11090 Protests - Timeliness
MAPM 11100 Protests - Suspended Corporations
MAPM 11110 Protests - Hearing
MAPM 11120 Protests Returned For Further Development
MAPM 11130 Protests - Correction Of Notices
MAPM 11140 Reinstatement Of A Notice To Protest Status
MAPM 11150 Follow-Up On Non-Final NPAs
MAPM 11160 Appeals – Recording And Disposition
MAPM 11170 Appeals From Notices Of Action - General Information

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## 11010 RECORDING A PROTEST

All Protest correspondence should be routed to the Protest Section, Protest Control Desk (PCD), Mail Stop D-12. The Protest Control Technicians will record the protest, update BETS and PASS, and send an acknowledgment letter to the taxpayers.
*All cases will be reviewed by a Protest Unit manager, supervisor, or designee to determine if the case should be handled by the Protest Unit, returned to the originating unit for further work, or referred to Legal.*
*When the protest is received in the Protest Unit, a copy of the original protest letter will be sent to the auditor who conducted the examination. This is to allow the auditor to respond to any issues raised in the protest letter, and to provide any additional information that may be helpful to the hearing officer in resolving the case.*
*Cases that are not fully developed have notices that were issued due to a failure to furnish information, or have notices that were issued due to an impending statute of limitations, may be returned to the originating unit for further development or consideration. If this occurs, Hearing Officers will be available to discuss the case. Upon completion, the case should be returned to the Protest Unit via cover memo along with the revised analysis/narrative report for final determination and processing.*
*In addition, the auditor will be contacted to discuss final protest determinations, which involve the following:*

- *a material revision/withdrawal,*
- *a revision/withdrawal that involves audit practice considerations, regardless of the amount,*
- *revisions/withdrawals that involve significant gray issues, or*
- *revisions/withdrawals on cases where the auditor has requested notification of the final determination*.

To verify receipt of a protest, users can check BETS R702 or PASS.

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## 11020 PROTESTS & APPEALS PROCESS

When the taxpayer and representative disagrees with audit's recommendations, the taxpayer and representative should be informed of the protest and appeal process.

### PROTEST PROCESS

According to R&TC §19041, protests against proposed additional tax must be filed in writing, within 60 days after the mailing of the NPA, with the Franchise Tax Board, Protest Section, Sacramento, CA 95867.

The taxpayers may file their protests on FTB Form 3531 PROTEST or in a letter-format detailing the pertinent protest information. See **MAPM 11080** for Requirements for a Valid Protest.

If requested, the taxpayer will be given an oral hearing. These hearings are informal and will normally be conducted in Sacramento or at one of the California field offices. If an oral hearing is not requested, the Hearing Officer assigned to the case will initiate correspondence to enable the taxpayer to submit information and documentation to determine whether or not the assessment is valid.

Upon resolving the protest, the taxpayer will be issued a Notice of Action. If the taxpayer disagrees with the protest determination, they may appeal to the State Board of Equalization or pay the deficiency and file a claim for refund.

### APPEAL PROCESS

The taxpayer has 30 days after the mailing of the Notice of Action to appeal in writing to the State Board of Equalization. If no appeal is filed within the 30-day period, the deficiency becomes final and the tax is due and payable within ten days after demand for payment is mailed to the taxpayer.

When an appeal is filed, both the Franchise Tax Board and the taxpayer will be given an opportunity to file additional information in support of their positions. The appeal will be set for an oral hearing before the Board of Equalization unless the oral hearing is waived by both parties.

Once the Board of Equalization has evaluated the facts and rendered a decision, the law allows for a rehearing requested by either party within 30 days of the decision. If no rehearing petition is filed, the Board's decision becomes final 30 days after it is rendered. If a rehearing petition is filed, the Board's decision on rehearing becomes final 30 days following the decision on the rehearing.

Once a decision is rendered by the Board of Equalization, it is final and binding on the Franchise Tax Board, but not on the taxpayer.

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The taxpayer may file in California Superior Court, after a denial by the Board of Equalization, by paying the tax and filing a claim for refund. After the California Superior Court has rendered its decision either the FTB or the taxpayer may file an appeal on the decision to the California Appellate Court and/or the California Supreme Court, and ultimately the U.S. Supreme Court.

## CLAIM FOR REFUND

The taxpayer may pay the deficiency and file a claim for refund at any time during the protest process.

If the Franchise Tax Board takes action to deny the claim for refund, the taxpayer has 90 days after the denial letter is mailed to either file or appeal with the Board of Equalization or initiate action in Superior Court. If the taxpayer files a claim for refund with the Franchise Tax Board, and it fails to act on the claim within six months, the taxpayer may file in California Superior Court as though the claim had been denied by the Franchise Tax Board. The appeals procedures discussed above would apply to the decisions of the California Superior Court.

## ASSISTING LEGAL DIVISION

The resolution of protest and appeals cases often involves either the gathering of additional information from the taxpayer's records or the verification of information submitted by the representative. In either situation, field audit activity may be necessary.

The scope of an assignment to assist the Legal Division is generally determined prior to auditor assignment. Additional information developed in the course of the assignment may indicate that the scope of field activity should be either limited or expanded. These recommendations should be discussed with your supervisor and legal.

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## 11030 CLASSIFICATION OF PROTESTS

*MOST PROTESTS ARE CLASSIFIED AS "UNDOCKETED" WITH THE BALANCE CLASSIFIED AS "DOCKETED." GENERAL GUIDELINES FOR CLASSIFYING PROTESTS ARE PRESENTED IN* ***MAPM 11040*** *AND* ***MAPM 11050****.*

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## 11040 DOCKETED PROTEST

If the basis given appears to involve an unclear question of law concerning material assessment amounts, and a hearing is requested, the protest may be referred to Legal for their consideration as a docketed protest. Generally, cases involving * * * * * * * in tax are referred to Legal

Whenever the Legal Division resolves a docketed protest, the taxpayer's file, along with a "greensheet", form FTB 6664 (Legal Division's Instructions), and transmittal form FTB 7023 are routed to the Technical Resource Section for issuance of the Notices of Action.

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## 11050 UNDOCKETED PROTEST

Protests not meeting the criteria for docketed protests are usually classified as undocketed protests. Undocketed protests are analyzed further to determine their dispositions. The Protest Unit will generally handle the undocketed protests. There are situations where the undocketed protest will be returned to the auditor for resolution. Such situations include assessments where the failure to furnish information penalty was issued or substantial documentation must be gathered.

See **MAPM 11120** for more information on protests returned for further development.

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## 11060 PROTESTS - PENDING FEDERAL (PF)

If the NPA was based on a Revenue Agent's Report (RAR) and the protest states that the taxpayer is protesting the federal adjustment, the case should be coded PF Protest and it is routed to the Protest Control Desk for processing. BETS * * will show the auditor's initials as PF.

The physical control of a Multistate PF Protest is maintained in Data Services and Storage (DSS). An In-Lieu sheet is placed in the folder by DSS showing the returns that they have removed from the folder and have under control for follow-up:

- When the taxpayer sends in the final determination, Data Services and Storage pulls the folder and routes it to Corporation Audit.
- The case is then assigned to an auditor who will act on the protest. Taking into consideration the final federal determination, the auditor will reconsider the proposed assessment and presents the findings to the taxpayer or its representative.
- If a hearing was requested, the auditor's letter should ask if a hearing is still desired. The auditor should keep in mind that the taxpayer does not need to reiterate its request for a hearing. Therefore, the auditor cannot discourage the taxpayer or the representative from exercising their right to an oral hearing.
- If the taxpayer requested a hearing and the hearing is still desired, the case should be transferred to the Protest Unit.

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## 11070 PROTESTS - FIELD AUDIT

If the NPA originated from a field audit and it is protested, it should be referred to the Protest Control Desk. The Protest Control Desk will record the protest in BETS and PASS. If the protest requires the auditor to continue to work the case, the protest will be returned to the originating office/auditor. In such a case, the auditor would continue to work the protest. After working the protest, the protest should be referred back to the Protest Unit with a cover letter indicating their final recommendation. If the taxpayer still requires a hearing, the Hearing Officer assigned to the case will conduct the hearing and resolve the protest. If the taxpayer is in agreement with the auditor's recommendation, the Protest Unit will issue the proper Notice of Action based on the auditor's final recommendation.

**See MAPM 11110** for information on hearing requests.

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## 11080 REQUIREMENTS FOR VALID PROTEST

California Revenue and Taxation Code §19041 provides that "within 60 days after the mailing of each notice of additional tax proposed to be assessed the taxpayer may file with the Franchise Tax Board a written protest against the proposed additional tax, specifying in the protest the grounds upon which it is based."

The Notice of Proposed Assessment (NPA) contains the procedures to file a protest. The NPA Insert - Form FTB 1014, is included with the NPA. This form explains the protest procedures and advises the taxpayer of the availability of the Franchise Tax Board Taxpayer Advocate.

In summary, the following criteria must be met before a letter will be recorded as a protest:

1. The letter must be timely. See **MAPM 11090**

2. The letter must state the taxpayer's name, account number, and tax year.

3. The letter must state the basis of the protest.

4. The corporation must be active, not suspended. See **MAPM 11100** and **MAPM 6170.**

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## 11090 PROTESTS - TIMELINESS

Compare the date the protest was received at Franchise Tax Board with the date of the NPA to determine that the protest was timely filed. Protests must be filed within 60 days of the date of the NPA. If the NPA was remailed to a better address, the 60-day period begins from the date the NPA was remailed. (The NPA copy will be stamped with "Remailed" and a date.) If it is determined that the protest was timely, see **MAPM 11010** for recording the protest.

Untimely protests will only be treated as timely if the delay is caused by the Franchise Tax Board. For reinstating the NPA to protest status after it has been finalized, see **MAPM 11130**.

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## 11100 PROTESTS - SUSPENDED CORPORATIONS

A suspended corporation is one that has had its corporate rights, privileges, and powers suspended by FTB or the Office of the Secretary of State (SOS). A corporation may be suspended for failing to file tax returns, pay taxes, pay assessments, or file the necessary documents with the SOS.

Since a suspended corporation has no privileges or rights, it cannot file a protest or appeal while it is suspended. The taxpayer must revive to good standing within the protest period or appeal period to have a timely protest. Always include NPA paragraph number 54477 if the taxpayer is suspended. (R&TC §23301.)

Also see **MAPM 6170** on Suspended Corporations.

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## 11110 PROTESTS - HEARING

California Revenue and Taxation Code §19044 provides that the Franchise Tax Board will consider the protest and, if an oral hearing was requested on the protest, a hearing will be granted. Hearings are generally conducted at any one of the California field offices. When a hearing is held, the Hearing Officer will generally inform the taxpayer that this type of hearing is informal; the purpose of it is to allow the taxpayer to present its position and/or provide any additional information supporting its position.

Protest cases where substantial documentation is needed or where the failure to furnish penalty was assessed will be returned to the auditor who issued the NPA(s). The Protest Unit will record the protest and notify the auditor that the protest case is being returned for further development/resolution of the protest. See **MAPM 11120** for protest cases returned for further development.

For more specific information regarding the Hearing Process, please click on the following link to the Protest Guide: THE HEARING PROCESS. * * * * * * * * * * * * * * * * * * * * * * * * * *

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## 11120 PROTESTS RETURNED FOR FURTHER DEVELOPMENT

In the event that it is determined that a protest case should be returned to the originating auditor, the auditor should continue to factually develop the protest case as in any audit. Once the auditor has completed the fieldwork and analysis, the auditor's findings/final recommendation on the case should be attached to a memo referring the case back to the Protest Unit or the Technical Resource Section, as warranted. If the taxpayer and representative are in agreement with the auditor's recommendation, a Hearing Officer will issue the Notice of Action(s) pursuant to the auditor's recommendation. If the taxpayer and representative are not in agreement with the auditor's recommendation, and they still require an oral hearing, the protest will be assigned to a Hearing Officer to conduct the oral hearing and resolve the case.

Judgment must be exercised in handling protest cases where a hearing is requested. When asking the taxpayer if the hearing is still desired, the auditor should not use language discouraging the taxpayer from exercising the right to a hearing. The auditor is reminded that under the provisions of the law, the taxpayer only needs to request a hearing once in the protest letter.

The auditor should follow the procedures below to ensure the protest is factually developed before referring the case back to the Protest Unit.

1. The auditor should independently review the case.

2. If the NPA is withdrawn, notify the taxpayer that a Notice of Action officially withdrawing the NPA will be issued in due course. (The Protest Unit will issue the Notice of Action – Withdrawal)

3. If additional information is required, the auditor should write to request it. The initial contact letter should acknowledge the protest letter. However, if a hearing was requested, do not ask if the taxpayer wishes to waive the hearing rights at this time.
4. Once all the facts have been gathered, the auditor needs to write a position letter, stating the issue, the facts, the governing law, and the auditor's findings. Allow the taxpayer a reasonable number of days to respond:
    - All position letters should include a paragraph at the end of the letter that gives the taxpayer an opportunity to agree or disagree with the auditor's position.
    - If a hearing was requested, a separate paragraph should be included at the end of the letter that will allow the taxpayer or representative to waive the hearing.

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NOTE: Notices of Action may never be made to increase the amount of tax and/or penalty on NPAs. In such a case, recommend affirming the previous NPA and prepare a new form FTB 6830 for the additional amount (if not barred by the statute of limitations) starting with the taxable income or net income as revised by the previous NPA as if it had become final. Withdrawal of the previous NPA and issuance of a new one is generally not in order unless the revised tax is on completely different grounds (and is not barred by the statute of limitations).

The following is an example of a closing paragraph that may be used by the auditor:

You have requested an oral hearing, and you have a statutory right to that hearing. Please check below indicating whether you want to exercise your right to a hearing or if you want to waive your right to a hearing.

____ Yes, I wish to have a hearing.

____ No, I want to waive the hearing.

In view of our determination, please indicate if you agree or disagree with our position.

____Yes, I agree with your position.

____ No, I do not agree with your position. Enclosed is a detailed response including case law, and source documentation supporting my position.

SIGNED: _____ DATED: _____

5. If the taxpayer still wants the hearing or does not specifically waive its right to a hearing in writing, the case should be referred to the Protest Unit. A letter of explanation should be sent to the taxpayer. For example:

This is in response to _____

Since you have requested an oral hearing, your case has been transferred to the Protest Unit. You will be contacted to schedule a hearing at a later date.

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If the auditor has done the necessary additional work at protest, developed all the facts, and communicated the legal analysis to the taxpayer and the taxpayer still does not agree with the auditor, the case must be referred to the Protest Unit as an unagreed case. The Hearing Officer assigned to the case will determine if a hearing is still required and will continue to work the protest case.

Even if the taxpayer is in agreement with the auditor's recommendation, if the recommendation is other than a withdrawal and the taxpayer has not agreed in writing to waive the hearing, the case should be treated as an unagreed case and referred to the Protest Unit for a hearing as explained above.

Upon completion of the protest, whether agreed or disagreed, the following procedures should be used to refer the protest back to the Protest Unit:

The case should be assembled with all protest correspondence on top.
Auditor notes and/or a Narrative Report clearly outlining the recommended action to be taken at protest should be included. The revised Narrative Report should be in the Protest – Reports Folder on PASS.
The auditor should complete a memorandum back to the Protest Unit. The memo should include reference to the protest being worked by the originating auditor, whether the taxpayer and representative are in agreement or disagreement with the auditor's recommendation, and if a hearing was waived (if applicable).
The auditor should transfer the PASS file to the group work list Protest – Unassigned.
The auditor should transfer the physical file to the Protest Unit, Mail Stop D-12.

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## 11130 PROTESTS - CORRECTION OF NOTICES

After a Notice of Proposed Assessment or a Notice of Action has been issued, the taxpayer occasionally submits supplemental information leading to further correction of the assessment. Depending on the circumstances, the assessment may be corrected by a second Notice of Action or a Notice of Revision; it may be withdrawn and a new NPA issued; or in the case of protested NPAs, it may be restored to protest status. The procedure to be followed is shown below:

### 1. To Correct an NPA Not Protested:

In the case of NPAs, which are not protested, a Notice of Revision (Form FTB 5932) must be issued prior to the expiration of the 60-day protest period or within the prescribed time if form FTB 6030, NPA - Defer Final Assessment, is appropriate. In no case will issuance of a Notice of Revision extend the protest period beyond 60 days from the date the NPA was issued. The corrected additional tax may not be increased over the amount of the additional tax originally proposed. The Notice of Revision shall bear a notation to the effect, "This notice supersedes the notice of proposed assessment dated (date)."

### 2. To Correct a NOA

In the case of NPAs that have been protested and a Notice of Action issued, a corrected Notice of Action must be mailed within the 30-day appeal period, or the notice of proposed assessment must be restored to protest status. The action taken by the mailing of the corrected notice will supersede the prior action and the taxpayer will have 30 days from the date of the corrected notice in which to file an appeal. The corrected additional tax may be increased over the amount shown in the notice of action, but may not exceed the amount of the additional tax originally proposed to be assessed. The corrected Notice of Action shall bear a notation to the effect, "This notice supersedes the notice of action dated (date)."

See **MAPM 11140** for reinstating notices to protest status.

### 3. NPA to be Withdrawn and New NPA Issued

An NPA may be withdrawn and a new one issued only if the statute of limitations has not expired and will not expire prior to the mailing of a new NPA. See **MAPM 9000** for the applicable statute of limitations.

In lieu of issuing a corrected Notice of Action or a Notice of Revision, consideration should be given to withdrawing the assessment and issuing a corrected one when:

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- The NPA contains a technical defect such as an error in the name, address, year, or transposition of numbers.
- The supplementary information received introduces new items of income or disallowance that may not be made a part of the corrected Notice of Action or Notice of Revision.
- The corrected amount of additional tax will exceed the original Notice of Action, Notice of Revision, or the original NPA. However, it may be better to let the Notices of Action or Revision stand and issue another NPA for any additional tax in excess of the Notice of Action, Notice of Revision, or the original NPA.

Other circumstances may arise and they should be judged on their merits. Approval of the supervisor should be obtained where doubt exists whether to withdraw and issue a new NPA or to issue a corrected Notice of Action or Revision.

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## 11140 REINSTATEMENT OF A NOTICE TO PROTEST STATUS

### NOTICES OF PROPOSED ASSESSMENT – RESTORED TO PROTEST STATUS:

Occasionally, NPAs becomes "final" in error. When it becomes necessary to reinstate the NPA to protest status, the following will be done:

1. The audit section that issued the NPA will route the corporation file to the Protest Control Desk with instructions, including the identification of notices to be reinstated. The Protest Control Desk technician will correct the account on the BETS.

2. The electronic PASS file should be transferred to the group work list "Protest - Unassigned" with a notation on the event log that the protest was received timely.

In order to determine whether the protest is considered timely, refer to **MAPM 11090**.

### NOTICES OF ACTION – RESTORED TO PROTEST STATUS:

If information is received in the audit section or Legal Division that will not permit corrective action within the appeal period, the file will be routed promptly to the Protest Control Desk with a request to have the NOA restored to protest status. The information must be received prior to the expiration of the appeal period to permit restoration to protest status.

If an NOA is restored to protest status, the taxpayer or the representative must be advised by letter, personal contact, or telephone. The Unit/Section or the auditor handling the case will make notification. Notifications made by letter should be worded substantially as follows:

> "In accordance with your (letter, telephone call, etc.) of (date), NPA No. _____ for the income year _____ has been restored to protest status and the notice of action issued (date) may be disregarded."

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## 11150 FOLLOW-UP ON NON-FINAL NPAS

In some instances, it is necessary to prevent an NPA from becoming final due to an obvious error or possible redetermination. In this event, the section/unit will defer the NPA from becoming final by requesting that the Protest Control Desk Technician place a hold on the NPA.

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## 11160 APPEALS – RECORDING AND DISPOSITION

When an appeal is filed with the Board of Equalization, the Appeals Section in the Legal Division is notified. The Appeals Section Technician obtains the taxpayer's file. After verifying the appeal information, the appeals are logged into BETS and PASS by the Appeals Section Technician.

After the Board of Equalization has resolved the corporation's appeal by either an opinion or a stipulation, the Appeals Section Technician receives the appellant information to verify jurisdiction. The Legal Division will refer the file to Review and Legal Support - MSA, Technical Resource Section for disposition. The case(s) will come with a cover sheet form FTB 7023 (Appeals Protest Transmittal) for issuance of the Notices of Determination. This includes cases resulting from appeals against the additional assessments as well as denials of claims. Appeals on jeopardy assessments involving illegal activities, (e.g., narcotics, bookmaking, pinball machines), are also referred to the Appeals Section Technician.

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## 11170 APPEALS FROM NOTICES OF ACTION - GENERAL INFORMATION

1. The Board's decision will be reviewed by the Technical Resource Section to determine how it relates to the notice (i.e., Affirmation, Withdrawal, or Revision). If the Board dismissed the appeal at appellant's request or because the appellant did not follow through, the Notice of Action will be affirmed.

2. Technical Resource Section will prepare a Notice of Determination. The file copy of the Notice of Action is used as a worksheet in the right margin. The following information will be completed in red pencil.
   a. Write the word "APPEAL".
   b. Write the abbreviation for the action being taken:
      - "AFR" for affirmation
      - "W/D" for withdrawal
      - "REV" for revision
   c. Write the unit number and initials. (e.g. 346:ABC)
   d. Below the body of the Notice of Action, write:
      - The current date.
      - A paragraph describing the action being taken.

3. Insert the Board's decision inside the most current return.

4. Review the appeal folder to determine if the corporation made any payment. If a payment was made, enter the standard payment paragraph on the worksheet.

5. On the form FTB 7023 (Appeals Protest Transmittal), the action taken, the routing, and the date are entered.

6. Enter the notice on BETS. To issue a NOR in BETS, follow the instructions provided in the "BETS NPA Procedures."

7. Route the corporation folder to the BE Technical Audit Support Unit for processing. The appeal folder is routed to the Legal Division. If a claim for refund is involved, route the corporation folder to the Corporation Claims Control Desk. The Claims Control Desk Technician will then refer the corporation folder to the BE Technical Audit Support Unit for processing.

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## 12000 REVENUE AGENT'S REPORT (RAR)

MAPM 12010 RAR - General Information
MAPM 12020 RAR Received In The Field
MAPM 12030 Information Copies To IRS
MAPM 12040 Request For Federal Returns and/or Audit Report
MAPM 12050 Correlating The RAR With Taxpayer's File
MAPM 12060 RAR - Audit
MAPM 12065 Federal Adjustments with a California Tax Effect in Different Years
MAPM 12070 Pending Federal
MAPM 12080 RAR - Taxpayer Not Identified
MAPM 12090 Recording RAR - Revenue
MAPM 12100 RAR Indicator Codes
MAPM 12110 Federal Adjustments Based On Copies Of Franchise Tax Board NPAs
MAPM 12120 RAR - Protests

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## 12010 RAR - GENERAL INFORMATION

The California Revenue and Taxation Code and Internal Revenue Code contain reciprocal provisions permitting an exchange of information. Under these provisions, the department receives copies of Revenue Agent's Reports (RARs) from the Internal Revenue Service. The reports are associated with the corporation folders and then forwarded for audit. If the RAR is attached to the corporation return, the first page of the return must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION". If the RAR is not attached to any other document the RAR must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION".

Taxpayer's may also report RAR changes by filing an amended return(s) or through correspondence.

Apportioning corporation RARs are processed at Central Office in the Multistate Audit Bureau and general corporation RARs are processed in the General Tax Audit Bureau. Apportioning corporations are defined as corporations doing business within and outside the state of California, or are filing a combined report. Exempt RARs are processed in the Exempts Unit.

For special statute of limitations provisions for RARs, see **MAPM 9000** and **MAPM 10050**.

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## 12020 RAR RECEIVED IN THE FIELD

RARs received in the field should be forwarded to the Multistate Audit Desk Audit Unit at Central Office for processing, along with surveyed or amended returns, unless the report is for years currently under field audit. When RAR and field audit years coincide, federal adjustments applicable for state purposes should be incorporated into the field audit.

RARs received in the field after an audit has been completed should be forwarded to Multistate Audit. If Multistate Audit is unable to process the RAR for any reason, they may return it to the field for assistance. Attention should also be directed to **MAPM 9000** and **MAPM 10050** regarding statute of limitations for RARs.

When a RAR is received in the field from a taxpayer or representative, the auditor should write across the top of the RAR in red **"Voluntary, date received** and **initial"** to prevent the loss of the statute of limitations, since special statutes apply when RARs are received within six months of final determination. This same procedure also applies to partial RARs. Sometimes the taxpayer or representative will provide only a page, or a few pages, of the RAR. This may be sufficient if the RAR information provided contains enough information to compute the adjustment. If not, the taxpayer should be notified that they have not met their legal requirements and that the entire RAR, or portions necessary to compute the adjustment, must be furnished for the special statutes to apply. This also prevents the representative from claiming the RAR was furnished timely when it was actually submitted after the required period.

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## 12030 INFORMATION COPIES TO IRS

An auditor making an adjustment that applies for federal purposes and is within the federal statute, should code the NPA to forward a copy to the IRS.

Consideration should be given to undisclosed income that may extend the statute beyond the normal three-year Federal limitation period.

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## 12040 REQUEST FOR FEDERAL RETURNS AND/OR AUDIT REPORT

All requests for federal tax information should be made on the Federal Tax Information Request - Form FTB 6227. Each request must be typed or printed in ink. This form can be found in the PASS workpaper file – * * * * * * * * * * * Once reviewed and signed by the reviewer (IRS designee), the form should be placed in the appropriate sort bin or routed to Central Office, Attention: 6227 Desk, Mail Stop D-734. **NOTE**: The reviewer's signature certifies that the requestor has a need to know and is only asking for what is necessary to resolve tax issues.

**NOTE**:

- DO NOT send the Federal Tax Information Request - Form FTB 6227 directly to IRS.
- If a second request is necessary, be sure to write, "SECOND REQUEST" on the 6227-request form.

A separate request should be completed for each taxpayer. In the case of the taxpayer filing a combined report, the request must be made for the parent that files the consolidated report with the IRS. A request can be made for more than one tax period and more than one type of IRS document on the same 6227 request form.

The type of information that can be requested from IRS includes the following:

- **MFTRA (Master File TRAnscripts) transcripts** - This includes the IMF (Individual Master File) and/or the BMF (Business Master File). These files are the tax accounts for each tax year. An IMF transcript is to be requested for individual taxpayers, and a BMF transcript is to be requested for all business entities such as corporations, partnerships and fiduciaries.
- **RTVUE (Return View) or BRTVU (Business Return View)** - These transcripts are an electronic snapshot of the originally filed returns for the last four tax periods filed.
- **Current Collection Information** - This information can be requested by writing, “latest address” or “all levy sources”, on the “Other (describe)” line on the 6227.
- **Copies of RARs/Tax Returns** - To obtain copies of Revenue Agent Reports (RARs) and/or tax returns, check the “Photocopy of Return” and/or “Photocopy of RAR” boxes.
- **Workpapers, Schedules or Other Documents** - To obtain copies of RAR documents, workpapers, schedules, etc., write a specific description of the data on the “Other (describe)” line.

**NOTE**: Copies of IMF or BMF transcripts are not to be given to taxpayers or their representatives. They contain 'official use only' information. Taxpayers and their representatives should be advised to contact the IRS.

**NOTE**: Prior to requesting RARs, tax return copies, workpapers, schedules, or other documents, a transcript should be obtained for each tax year. If the case has an open audit indicator or is currently

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in litigation, the IRS will NOT be able to obtain the file. You must wait for the case to be closed before the file will become available.

If the review of the transcript indicates the need for additional documentation, the request for RARs, tax return copies, workpapers, schedules, or other documents may then be made. The transcript should be attached to the new request. The transcript should be less than 30 days old.

Requests for transcripts should take 2-4 days. All other information requests can take from 4 to 6 weeks. If the requested information is not received within these time frames and a second request is necessary, be sure to write, "SECOND REQUEST" on the 6227-request form.

**VERY IMPORTANT:**

**We are required by Internal Revenue Code §6103(p)(4) to establish and maintain, to the satisfaction of the Internal Revenue Service (IRS), safeguards to prevent unauthorized use and to protect confidentiality of federal tax information (FTI). Therefore, the following procedures should be followed when FTI has been obtained.**

**Business Master File (BMF) Transcript Requests:**
If a BMF transcript is obtained and the related case results in a "Survey" then the transcript must be returned to central office, Audit Business Support Unit. If any information from the transcript is used to substantiate an audit determination, then the transcript can be retained in the audit file and the transcript does not have to be returned. If the determination is a “No Change” please route a COPY of the form 6227 **(not the FTI)** to the Audit Business Support Unit, by using the reverse side of the route slip attached to the FTI.

**FTI Mailed/Routed From Central Office to Field Offices:**
A transmittal sheet is used to record the sending and receipt of FTI. It must be signed and dated to document the mailing and receipt of the FTI. Please fax the transmittal sheet to the number listed on the form.

The first page of all audit files containing IRS information must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION". The Form 6227 used to request additional IRS data should always be kept with the case, and never thrown away. It is a record that should be maintained until the file goes through the normal destruct process.
**NOTE**: * * *

## 12050 CORRELATING THE RAR WITH TAXPAYER'S FILE

When an RAR is received from the IRS, Multistate Audit will obtain the folder from Data Services. The auditor assigned the RAR must first review the taxpayer's file to determine an appropriate action based upon the following steps: **VERY IMPORTANT:** The first page of all audit files containing IRS information must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION".

1) Determine if an NPA has been issued for each taxable year covered by the RAR. Review the * * * * * * * * * *to make this determination. Also check to see if an amended return has been filed reporting the RAR changes.
2) If an NPA has been issued, determine the extent, if any, that the RAR issues were adjusted. The RAR adjustments may have been incorporated with a previous FTB Field Audit NPA or an NPA reflecting the RAR adjustments may have already been issued. Review the Narrative Report to determine this. The auditor must take care not to duplicate RAR adjustments that have previously been made.
3) If a copy of the RAR is in the file and has already been issued or reported in an amended return, the auditor may either destroy the RAR or write “duplicate/already worked” in red on the RAR and place it into the file.
4) If the NPA does not include the RAR adjustment, issue an NPA using the prior NPA or last return accepted as the starting basis for your NPA. This includes combination in a manner consistent with that of the audit determination, as well as using the apportionment percentage per the audit determination. If the RAR years were settled by the Settlement Bureau, the settlement agreement may contain the apportionment percentage for future RAR adjustments.
5) If no NPA has been issued, the auditor should determine if the returns are in the field. If the RAR years are under current audit by the field, route the RAR to the appropriate program office using form FTB 7024. If only some of the returns are in the field, send a copy of the RAR with a notation to inform the field auditor what years will be issued by central office. If the RAR is on PASS, the auditor must correctly transfer the case to the appropriate Program Office or responsible owner.

If none of the above steps apply, audit the RAR as discussed in **MAPM 12060.**

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 12060 RAR - AUDIT

As a general rule, we try to follow IRS audit determinations in order to make efficient use of resources by not duplicating work performed by the IRS. When the IRS has not performed an audit, however, our examination of issues where state and federal law conform is not a duplication of efforts. In fact, if we blanketly accept unaudited federal net income and only examine areas where state and federal law differ, the majority of revenue base will remain unverified. We could be missing large adjustments by not taking a closer look at the components of federal net income.

The guidelines with respect to the most common situations encountered with federal audits are summarized below:

1. Where a federal audit has been performed:

   Where state law conforms to federal, we will follow the federal treatment of items that have been included in the scope of a federal audit.

2. Where there has been no federal audit, or where the federal audit was limited in scope:

   Where the IRS has not conducted an examination of an item, normal criteria for determining audit potential should be applied to all issues, regardless of whether state and federal law are the same. The same holds true for issues which were not included in the scope of a federal audit. In the later case, evidence of the IRS scope limitation should be included in the audit file.

Keep in mind that when water's edge taxpayers are involved, Revenue and Taxation Code section 25114 may be applicable. In general, that statute provides a presumption of correctness for determinations resulting from detailed IRS pricing audits. The presumption applies equally whether the determination is for an adjustment or for no change. To overcome the presumption, either FTB or the taxpayer must show that:
*

a. * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *
b. * * * * * * * * * * * * * * * * * * *

Although the above presumption applies only to water's-edge taxpayers, it echoes the general audit guidelines.

**a. Common Federal Adjustments**

When auditing RARs, auditors must determine whether or not the changes as shown on the RARs are applicable for state purposes. Some common federal adjustments that should be eliminated are:

- * * * * * * * * *
- * * * * * * * * * * * * * * * * * * * * * * * *
- * * * * * * * *
- * * * * * * * * * * * * * * * * * * * * * * * * *
- * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

**Federal adjustments to a Net Operating Loss (NOL) should not be made; rather a NOL should be considered under California statutes.**

**b. Analyzing the RAR**

The following instructions apply when analyzing an RAR:

1. Survey or No Change - If no adjustments from the RAR are applicable for California purposes, or if a negative taxable income precludes an NPA, that year should be "Surveyed." If contact has been made with the taxpayer and it has been determined that the RAR adjustments will not result in a tax effect, the RAR should be “No Changed.” If the RAR adjustments do not result in a tax effect, but will have an impact on the NOL, write “NOL-RAR Revision,” on the NOL line on the face of the return. Indicate any changes shown on the RAR that are not applicable for state purposes by the notation "N/A" on the specific item.

2. Change RAR - Review the file to determine whether any state adjustments are required in addition to the applicable RAR adjustments (assuming the regular statute of limitation is open.) Make all adjustments by issuing either an NPA or an O/A, as required.

3. Reconciling - If the starting income shown on the RAR cannot be reconciled with the "net income before state adjustments" and the difference is questionable and results in a material tax difference, the auditor may want to contact the taxpayer for an explanation. The auditor should keep in mind

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that differences may exist because of an NOL, non-unitary corporations, and the taxpayer's filing on a worldwide basis. If correspondence is initiated, the auditor is responsible to maintain the statute of limitations. See **MAPM 9000**.

4. If the RAR is stapled to the corporation return, the first page of the return must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION". If the RAR is attached to the audit file the first page of the audit file must be stamped with the following, "FILE CONTAINS CONFIDENTIAL IRS INFORMATION".

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## 12065 FEDERAL ADJUSTMENTS WITH A CALIFORNIA TAX EFFECT IN DIFFERENT YEARS

The tax effect of a Revenue Agent Report adjustment may apply to different years for California purposes than federal purposes for such issues as net operating losses, tax credits or other carryover items. For example, a taxpayer incurs Research & Development expenses in 1996 and claims a federal research & development credit. The amount of the federal credit exceeds the federal tax in 1996, so the excess credit carries forward to 1997 and 1998. While the federal statute of limitations is open for 1997 and 1998, the Internal Revenue Service examines the carryforward credits claimed for those years and makes a final federal determination that the original expenses claimed on the 1996 return were excessive. . The expense adjustments have no net federal tax effect for 1996, but reduce the amount of the federal credit carryforward to 1997 and 1998. This results in federal assessments of additional federal tax for those years, based on the disallowance of expenses originally claimed on the 1996 federal return. The taxpayer had claimed a California Research & Development credit that is fully used in 1996. Assume the normal California statute of limitations has expired for assessments of additional California tax for 1996

Under our prior application of the law, the Audit Division ignored the application of federal carryforwards and would propose adjustments under Revenue and Taxation Code section 19059/19060 or allow claims under Revenue and Taxation Code section 19311 only for years where there was a federal tax change so no assessment would have been issued for California purposes based on the final federal determination in the above example. We based our position on FTB Legal Ruling 280 (dated 11/02/64, legislatively overruled in 1967 and formally withdrawn by L.R. 98-2 on 05/12/98). Under our revised practice, an NPA would be issued for 1996 reflecting the federal disallowance of 1996 expenses that gave rise to the federal changes actually made for federal purposes to the 1997 and 1998 federal tax years.

ANALYSIS

Revenue and Taxation Code section 18622 requires taxpayers to report federal changes to any item shown on the federal tax return, including changes to income, deduction, penalty credit or tax for any year to the Franchise Tax Board. For individuals, the change must be reported only if the federal changes increase the amount of California tax payable for any year. Revenue and Taxation Code section 19059 provides that if the taxpayer does meet their reporting requirement under Revenue and Taxation Code Section 18622 within six months of the final federal determination, the Franchise Tax Board has two years to propose a deficiency "resulting from those adjustments". Revenue and Taxation Code section 19060 provides extended time periods for issuing deficiency assessments if the taxpayer fails to report a change as required by section 18622 or files it after the prescribed period. Revenue and Taxation Code section 19311 also authorizes the Franchise Tax Board to allow a claim for refund resulting from federal adjustments.

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**Note**: The changes or corrections need not be reported unless they increase the amount of tax payable under Part 10 (individuals) for any year (Revenue and Taxation Code section 18622(a)). If a change or correction is made by the Internal Revenue Service, a claim for credit or refund resulting from the adjustment may be filed by the taxpayer within two years from the date of the final federal determination (as defined in Section 18622) or within the period provided in Section 19306, 19307, or 19308, whichever expires later. Revenue and Taxation Code sections 19059 and 19060 apply to issuance of deficiency assessments.

Legislative history reflects the intent of the Legislature was not to allow the Franchise Tax Board an open-ended statute for issuing deficiencies to otherwise closed years where the taxpayer reported the federal adjustments as required by law. The legislature specifically adopted an open-ended statute in Section 19059 for assessments where the taxpayer failed to report federal changes as required by law. Based on the history of legislative changes to Revenue and Taxation Code sections 19059 and 19060, the Franchise Tax Board now has timeframe limitations in which to assess additional taxes triggered by the receipt of federal changes.

* * * *

issuing deficiencies. Second, Revenue and Taxation Code sections 19059 or 19060 do not limit the California adjustments to the same year as the federal assessments.

Another example: Internal Revenue Service issues a Revenue Agent Report for Year 1, proposing an increase to income of $10,000. Taxpayer successfully argues the Internal Revenue Service assessment notice was mailed to the wrong address and so is invalid. In this case, California may not propose an assessment because there was no federal determination as there was never an actual assessment based on the federal Revenue Agent Report.

Revenue and Taxation Code section 18622 (a) and (b) require the taxpayer to report federal changes for any year that increases California tax for any year. Although changes only need to be reported by individuals if they increase the amount of California tax for any year, the statute was specifically amended in 1993 to clarify that due to state and federal differences in carryovers and credits, a federal adjustment for one year could result in a California tax change in a different year.

Revenue and Taxation Code sections 19059 and 19060 authorize the Franchise Tax Board to issue a Notice of Proposed Assessment resulting from federal adjustments required to be reported under Revenue and Taxation Code section 18622 (a) and (b). Nothing within Revenue and Taxation Code section 19059 or 19060 requires the Notice of Proposed Assessment be issued for the same year as the federal tax adjustment resulting from the final federal determination of a change to income, deductions or credit amounts. They allow assessments for all adjustments that "result from" the federal determination. Similarly, Revenue and Taxation Code section 19311 uses the same "resulting from" language when granting the taxpayer the right to file a claim for refund within two years of the final federal determination; therefore, the same rationale would apply when allowing claims for refund. A taxpayer can claim a refund for a different year than a federal refund was allowed if the California tax effect is in a different year due to the application of carryforwards or other state-federal differences.

This change in practice will close a major loophole in our current practice that limits assessment of additional tax where there is a federal or state carryover that causes a federal tax determination to have tax effects in different years for California and federal. This is especially important where the California NOL deduction is suspended for a year that a federal NOL is allowed. For example, the Internal Revenue Service audits two identical taxpayers A and B for 2002. A has a large federal NOL carryforward from 1998 and B does not. The Internal Revenue Service increases an item of 2002 income for both A and B. Because of the federal NOL, A has no tax change in 2002, but the adjustment reduces the NOL available for 2003, causing a federal deficiency. B has a federal deficiency in 2002, the year of the adjustment. Under existing audit practice, B gets a California assessment based on the federal determination, but A does not. Under the proposed change, both A and B would get identical California assessments for 2002.

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## a) APPLICATION

We estimate ten percent of Revenue Agent Report's processed by the Audit Division have federal adjustments with a California effect in different years. Currently, we have claims for refund impacted by the change in procedure where the refunds will go back as far as 1989.

The change in procedure has significant administrative impacts for both the taxpayer and the department. The department destroys tax returns on a scheduled basis and not all taxpayers retain tax returns and accounting records beyond the normal statute of limitations.

## b) CONCLUSION

We will allow claims for refunds and may pursue deficiencies for **any year** impacted by a federal adjustment reflected on a Revenue Agent Report in accordance with our business standards. If you have any questions or concerns, please contact * * * * * * * * * * * * * * * * * * * * * * * * * * *

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## 12070 PENDING FEDERAL

### Unagreed RAR

Sometimes an RAR is received that is "unagreed" or is pending a federal determination in tax court. We have an agreement with the IRS not to issue assessments on unagreed RARs received from the IRS until a settlement is reached.

Prior to 1/1/2000, a final federal determination was defined as an irrevocable determination or adjustment of a taxpayer's federal tax liability from which there exists no further right of appeal either administrative or judicial. In other words, there was only one final federal determination per year. After 1/1/2000, the law changed and the date of each final federal determination is the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to IRC §6203. In other words, there can be more than one federal determination per year. The easiest way to identify the final federal determination date is the date the assessment posts to the Business Master File (BMF).

After 1/1/2000, the auditor should determine if the assessment is final vs. whether the taxpayer agrees or not. It is possible the taxpayer could allow the RAR to finalize, pay the assessment and file a claim for refund. If we delay issuing the assessment until a decision is issued on the claim, we may find the statute expired to issue the assessment.

If the taxpayer files a claim based on a federal report that is not final, the auditor has the option to forward the claim along with all related material (original return, prior amended returns, field audit reports, protest reports, etc) to the Multistate RAR Unit – PF coordinator.

### Pending Federal – Audit in Process

If during an audit, you are notified by the taxpayer or representative that the Internal Revenue Service is auditing the same or different years, the case should be classified as a "pending federal" case if the federal examination is not complete.

Follow-up activity on "pending federal" cases is performed by the support staff in the Multistate Desk Unit at Central Office. To facilitate follow-up, make sure the name and phone number of the IRS contact is in the file. In addition, mark the box on FTB Form 6430 to indicate an IRS examination is in process and provide a workpaper reference on the f/u date line. (Form 6430 will be revised in the future to replace the f/u line with a workpaper reference line.)

### REQUIRED ACTIONS – Pending Federal Cases

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- Determine that an IRS audit is in process by gathering substantiation from the taxpayer, (for example, scheduling information or any type of audit contact), and an NPA has been issued, for an unagreed RAR.
- Contact the taxpayer by telephone or by letter to inform them that the case is being referred to Pending Federal.
- Change the initials on inventory listing to PF and refer the case to the Pending Federal desk. The auditor should make all necessary transfers or updates on PASS.

Annually the Pending Federal desk will send a follow up letter to determine the status of the IRS action. If the taxpayer replies that IRS action is still in process, the pending federal desk will change the inventory list for a follow-up to the next year. If no reply is received or after the case has been in Pending Federal for three years, the Pending Federal desk will complete form FTB 6227, requesting a BMF transcript to determine if the IRS has closed the case. Once the BMF transcript is received, the case will be referred to an auditor for analysis.

No action is taken on a Pending Federal case until the final federal determination has been made. Pending Federal cases are sent to Data Services and held for one year. A letter is then sent to the taxpayer requesting the status of the Internal Revenue Service audit. When the taxpayer responds to our request with a final federal determination the case is pulled from Data Services and sent to the initiating auditor to be worked.

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## 12080 RAR - TAXPAYER NOT IDENTIFIED

Occasionally, Multistate Audit receives an RAR on a corporation for which no record can be found. In those cases, the FEIN and alpha cross-reference files should be checked on BETS * * *. If the corporation is not found, send special letter form FTB 4841 to the corporation. If no reply is received, the case is referred to the unit supervisor for final determination and disposition. The supervisor may close the file or refer it to the appropriate field office, filing enforcement, etc.

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## 12090 RECORDING RAR - REVENUE

Only one revenue code may be used to record revenue from an NPA. The additional assessment cannot be split to credit a portion to RAR and a portion to another audit program. When making assessments that contain both RAR and other audit adjustments, credit the revenue to the audit program that generates the revenue.

For example, while reviewing an amended return requesting a $2,000 refund based on an RAR, the auditor noticed a Non-RAR adjustment resulting in additional tax of $1,000. In this case, the RAR revenue code would be used, since the revenue was found under the RAR audit program.

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## 12100 RAR INDICATOR CODES

The sixth digit of the seven-digit revenue code is used as an IRS Indicator Code to identify adjustments based on RAR.

See **MAPM 16010** for specific Revenue Codes.

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## 12110 FEDERAL ADJUSTMENTS BASED ON COPIES OF FRANCHISE TAX BOARD NPAS

If the RAR was the direct result of the federal government receiving a copy of our NPA and the adjustments are the same, place the RAR in the folder and return the case to files.

However, if the adjustments are not the same, complete as follows:

- Original NPA was issued by Multistate Audit and not protested.
  Make all changes applicable to conform to the RAR.
- Original NPA was issued by Corporation Audit Section protested and notices of action issued.
  Discuss with the unit supervisor.
- Original NPA issued by field auditor and not protested.
  Allow field audit adjustments to stand if such adjustments are similar to those on the RAR. If different, discuss with the unit supervisor for possible adjustment or re-referral to field for determination.
- Original NPA issued by field auditor, NPA protested and notice of action issued.
  Discuss with the unit supervisor.

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## 12120 RAR - PROTESTS

When a taxpayer protests an NPA on the basis of pending federal action, it is considered to be a "Pending Federal (PF)" case. (Designated PFI for general corporations.) The taxpayer will generally file a protest with the department requesting that no further action be taken on the NPA(s) pending the final federal settlement.

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## 13000 WATER'S-EDGE

MAPM 13010 Water's-Edge - General
MAPM 13020 Procedures For Processing Water's-Edge Contracts - Introduction
MAPM 13030 Processing Problems
MAPM 13040 Terms/Abbreviations
MAPM 13050 Water's-Edge - First Year Elections, Contract Attached
MAPM 13060 Water's-Edge - First Year Elections, Contract Not Attached
MAPM 13070 Reporting - Water's-Edge Election Pre-1994
MAPM 13090 Water's-Edge - Foreign Parent List
MAPM 13100 Water's-Edge - Box Checker Returns - Background
MAPM 13110 Support Staff - Processing Water's-Edge First-Year Returns
MAPM 13120 Completion Of Forms - Cancellation Of Water's-Edge Penalties
MAPM 13130 Water's-Edge Failure To Furnish Information Penalty

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## 13010 WATER'S-EDGE - GENERAL

For taxable years beginning on or after January 1, 1988, taxpayers may elect to file on a water's-edge basis. Under a water's-edge election, affiliated foreign corporations are generally excluded from the combined report. However, the election does not supersede the concept of unity; it merely limits the unitary entities included in the report.

For a discussion on the concepts of the unitary method of taxation and its application by California, please refer to Title 18, CCR §25106.5 et seq. and FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report. For discussion on corporations making a water's-edge election and the entities included in a water's-edge combined report, see R&TC §25111 and R&TC §25110.

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## 13020 PROCEDURES FOR PROCESSING WATER'S-EDGE CONTRACTS - INTRODUCTION

To make a proper water's-edge election, each taxpayer must enter into a contract with the Franchise Tax Board by filing a water's-edge contract at the time the original return is filed for the taxable year which the contract is to be effective. The water's-edge contract may not be entered into through an amended return (Regulation 25111-1(e)). Title 18, CCR §25111-1(e)(1) now defines the term original return as the last return filed on or before the due date (taking extensions into account) regardless of the form on which it is filed or however it may be denominated. If no return is filed by that date, the first return filed after the due date (taking extensions into account) is considered the original return.

For taxable years beginning in 1988 and 1989, form FTB 1115 was used to enter into a water's-edge contract. For taxable years beginning in 1990 and after, the form number was re-designated as form 100-WE, Water's-Edge Contract. This form must be attached to the original return for the first year the contract is to be effective.

For taxable years beginning on or after January 1, 2000, taxpayers filing on a water's edge basis are required to use the new Form 100W, California Franchise or Income Tax Return – Water's-Edge Filers. However, taxpayers electing water's-edge for the first time are still required to attach Form 100WE, Water's-Edge Contract, to their original returns even if they are using the new Form 100W.

Please be aware that there is no Form 100W for S corporations that have elected water's-edge treatment. That is, water's-edge S corporations must continue to file using Form 100S, California S Corporation Franchise or Income Tax Return, and attach Form 2426, Water's-Edge Cover Sheet, to the front of their returns.

For taxable years beginning on or after January 1, 1994, significant revisions were made to the water's edge provisions. These revisions included:

- Revocation of all contracts entered into for taxable years beginning prior to January 1, 1994
- Requiring new elections for banks and corporations desiring to file on a water's-edge basis for taxable years beginning on or after January 1, 1994
- Revision of the contract period from 60 months (five years) to 84 months (7 years)
- Elimination of the water's-edge election fee
- Elimination of the requirement for water's-edge taxpayers to file a Domestic Disclosure Spreadsheet
- Revisions to the termination provisions of the water's-edge election
- Elimination of provisions that allowed the Franchise Tax Board to disregard a water's-edge election for specified reasons

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- Addition of the “Substantial Performance “ test in determining the validity of a contract

On October31, 1998, Title 18, CCR §25111 and CCR §25111-1 were amended to provide relief for taxpayers who intended to make a water's-edge election but who failed to fulfill the procedural or statutory election requirements.

The amendments to Title 18, CCR §25111 and CCR §25111-1 retroactively modified the requirements for making a valid water's-edge election. Under the amended regulations, even if there has been noncompliance with one or more procedural or statutory requirements for making the election, a water's-edge election will be considered valid if the tax was computed on a water's-edge basis and there is additional objective evidence to support the conclusion that an election was intended. (An example of objective evidence would be filing of Form 100W, or any substantially completed water's-edge form attached to the return.)

The amendments to regulation Sections 25111 and 25111-1 added a "substantial performance" test to relax the strict criteria that formerly had to be met in order for a water's-edge election to be valid. This new test provides that if a taxpayer fails to attach a contract to its original return, the water's-edge election will still be considered valid if the tax was computed on a water's-edge basis and if there is additional objective evidence to support the conclusion that an election was intended. The regulation provides several examples that constitute objective evidence such as attaching to the original return one or more water's-edge forms (i.e., Forms 100-FEE-A, 2411, 2416, 2424, 2426), or attaching a statement to the original return indicating that a water's edge election was being made.

As stated above, all contracts entered into for taxable years beginning prior to January 1, 1994 were rescinded. Taxpayers wishing to continue filing on a water's-edge basis are required to make a new election for taxable years beginning on or after January 1, 1994. For more information, see Water’s-edge Booklet 100-WE, which contains various instructions and water's-edge forms.

The MSA Technical Resource Section (TRS) was previously responsible for pre-screening all new contracts filed for taxable years beginning on or after January 1, 1994. This process resulted in identifying problems with water's-edge elections early in the audit process. However, as a result of the adoption of amendments to Regulations §25111 and §25111-1 in October 1998, TRS no longer pre-screens each contract before sending cases to the field. Audit staff is now responsible for verifying the validity of an election. However, staff may continue to seek the assistance of TRS specialists.

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## 13030 PROCESSING OF WATER'S-EDGE CONTRACTS

Form 2426, Water's-Edge Cover Sheet - Prior to 1993, Forms 100 and 100S contained a checkbox on the front page used by taxpayers to indicate whether water's-edge was elected. In numerous instances, the box was checked in error. The box was deleted for taxable year 1994 through 1996. The water's-edge box was again used on the corporate Form 100 for taxable years 1997, 1998 and 1999. For taxable years beginning on or after January 1, 2000, water's-edge taxpayers are required to use the new Form 100W and are no longer required to attach Form 2426 to the front of the return.

Form 2426 is still required to be attached to the front of the water's-edge returns being filed for the year 1999 and prior, and for all S corporation returns being filed on a water's-edge basis. In the past, this form was not always attached to the front of the return. If not attached, the return may inadvertently get processed and posted to BETS as a worldwide return. Accordingly, when scoping returns for audit, it is very important to review the return for a water'-edge contract. If a contract is found, make sure the contract information is posted to BETS (* * * * * * * * *). If not on BETS or you are unsure whether the contract is posted, contact a TRS specialist for assistance.

Affiliation or Name Changes - It is common for unitary groups to change key corporations under which a combined report was filed. For example, in one year a water's-edge election is filed under a particular taxpayer's name while in the subsequent year the election is filed under another name. The subsequent year may appear to be a first-year return without the proper forms, or it may appear as an invalid election. Usually when this occurs, the taxpayer will indicate that a change has transpired and will attach a list of entities included in the return. This list can be used to identify the original water's-edge taxpayer. A review of BETS and the taxpayer's list of entities covered by the election may also be used to identify these changes. If the key corporation has changed, a new water's-edge shell is created in BETS under * * * * * * * * *, and the status is shown under * * * * * * * * * as "transferred". This means that the water's-edge contract is still valid, but it was originally made under a different corporate number.

Deemed Election - A water's-edge election is a tax attribute which carries over to and is binding upon an acquiring corporation or a distributee of property in complete liquidation of a water's-edge taxpayer. In addition, if a non-electing affiliate is subsequently proved at audit to be a unitary member of the electing water's-edge group, the non-elector is deemed to have made a water's-edge election effective as of the date that it is proved to be unitary with the water's-edge group, and it is bound by the water's-edge rules for the remaining period of the contract. Therefore, before invalidating an election or accepting worldwide combination, consideration must be given to the deemed election rules and how the rules apply to the taxpayer.

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EXAMPLES:

- Corporation A filed on a water's-edge basis pursuant to §25110 for a period of 84 months beginning in 1994 and ending in 2000. Corporation B makes no water's-edge election and files its 1994 and 1995 returns on a worldwide basis. In 1996, audit determines A and B are unitary during this period. Accordingly, B is deemed to have made a water's-edge election effective as of the date of A's election in 1994.
- Same as (1) above except that B filed its 1996 return on a worldwide basis pursuant to §25101. B then files an amended return re-determining its tax liability on a water's-edge basis. In reviewing the 1996 amended return, our first impression is that B's water's-edge election is invalid. However, due to audit's determination that B was deemed unitary with A in 1994, B's amended return is proper.
- Corporation P has never made a water's-edge election and files its returns on a worldwide basis. T and subsidiary S were unitary and elect water's-edge treatment for a period of 84 months beginning in 1994 and ending on December 31, 2000. On September 30, 1996, T sold S to P. P and S were considered instantly unitary as of September 30, 1996. From September 30, 1996 to December 31, 2000, P is deemed to have elected and shall be subject to the terms of S's water's-edge election. However, S may terminate the election if certain criteria are met.

Other - The taxpayer may claim a proper election was made in an earlier taxable year. If this occurs, request all potential water's-edge returns to determine whether a valid election was made and if so, for which taxable year(s).

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## 13040 TERMS/ABBREVIATIONS

CONTRACT - Equivalent to California Form 100-WE, which was previously designated as form 1115

WATER'S-EDGE LISTING – A report maintained by TRS titled "Taxpayers Electing Water's-Edge"

CP – Group within BE Audit Technical Support responsible for processing water's-edge returns.

R&S - Research and Statistics

Water's-edge Stand Alone PC – Water's-edge database maintained in a computer in BES and a back-up computer in the Technical Resource Section.

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## 13050 WATER'S-EDGE - FIRST YEAR ELECTIONS, CONTRACT ATTACHED

Form 100-WE contains the contract language used for elections made on or after January 1, 1994. The steps listed below should be considered in determining whether the taxpayer has made a valid election. The auditor should also apply the substantial performance test (added to Regulations §25111 and §25111-1) in evaluating the validity of an election.

1. Does the corporation name and number on the contract correspond to the corporation name and number shown on the face of the return? If yes, go to step (5). If not, go to step (2),

2. Review the return and taxpayer's BETS account to determine whether:

   - The taxpayer is making a new water's-edge election. If it is a first year return, proceed to step (3);

   - There is an existing water's-edge contract in effect; or

   - The return is actually a subsequent year of another taxpayer' election. If determined to be a subsequent year, contact TRS. The TRS will update BETS.

3. If the corporation name does not agree with the return, write the key corporation name on the top of the contract in pen. Proceed to step (4).

4. If the corporation number on the contract does not agree with the return, write the key corporation number on the top of the contract. Proceed to step (5).

5. The date entered (middle of the contract) should be the first day of the taxable year. Does the date entered on the contract agree with the beginning date of the taxable year shown on the face of the return? If yes, proceed to step (7). If not, proceed to step (6).

6. Call the taxpayer to obtain authorization to correct the date. Revise the date and put an "*" by the revision. At the bottom of the contract add a comment such as "*Revision authorized by Tom Smith, Controller, (916) 123-4567, on 10/20/94." Initial and date the comment. Proceed to step (7).

7. For taxpayers filing on a combined basis, check to see if the box in the middle of the contract is checked. If checked, verify (to the extent of available information) the water's-edge elector is the entity that can make an election on behalf of its affiliates included in the water's-edge combined report. A common parent of a controlled group that files a consolidated federal return, or the common parent wherever domiciled or organized, may file an election binding upon all members of the controlled group that are part of the water's-edge combined report group. Direct or indirect ownership of more than 50% of voting stock establishes control. The common parent need not be a California taxpayer.

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8. If the ultimate parent does not make the election, verify that separate contracts are filed for each taxpayer. An election might not valid if a contract for each member of the combined group is not attached to the combined report.

9. Proceed to **MAPM 13090**, Reporting - Water's-Edge Listing.

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## 13060 WATER'S-EDGE - FIRST YEAR ELECTIONS, CONTRACT NOT ATTACHED

1. For 1994 and subsequent, corporations wishing to file on a water's-edge basis must make a new election by attaching a contract to the original form 100 or 100S for the first year the contract is to be effective. If a contract is not attached, the election may not be valid. However, even though not attached, an election will still be considered valid so long as the substantial performance test (SPT) outlined in Regulation §25111-1 is met. A thorough review of the return using SPT criteria should be performed in these instances. If no evidence of an election is apparent, access BETS * * * * * * * * * * * *. These * * * * * * * are maintained by BE Audit Technical Support for keying and tracking water's-edge contract information. If SPT is not met and no information is found in * * * * * * , go to step 2.
2. Review the BES contract file to ensure the contract was not inadvertently detached from the taxpayer's return during processing. Is the contract in the BES file? If yes, proceed to step (3). If not, proceed to step (5).
3. Make a copy of the contract. Leave the copy in the BES file, and review the original contract for evidence to determine if the contract was filed separately by the taxpayer <u>or</u> if the contract was detached from the return during processing. Examples of evidence include a "Received Date" stamp, staple holes, or fold creases. If you cannot determine that the contract was mailed separately, you must assume the contract was detached from the return during processing. Consult with your supervisor as to whether you should make this assumption. Was the contract filed with the return? If yes, proceed to step (4). If not, proceed to step (5).
4. Re-attach the contract to the return. Add a comment to the return such as "The contract was filed with the return. However, it was erroneously removed during processing. The taxpayer does have a valid election." Initial and date the comment. Proceed to **MAPM 13050**.
5. If the contract was not filed, or the contract was filed separately on a day other than the day the return was filed, proceed to step (7). If the contract was filed on the same day as the return, but in a separate envelope or in the same envelope as the return, proceed to step (6).
6. Re-attach the contract to the return. Add a comment to the return such as "The contract was filed on the same day of the return. [Explain the circumstances.] The taxpayer does have a valid election." Initial and date the comment. Proceed to **MAPM 13050**.
7. If there is no contract attached and there is no evidence of substantial performance, notify the taxpayer in writing that the attempted water's-edge election is not valid. Use the appropriate letter and proceed to step (9).
8. Hold the return for one month in case the taxpayer contacts you. After a month, attach the form from step (7) to the return. Give the return to support staff to have the entire return copied. Keep the copy.
9. When the return is received from BES after processing, review the water's-edge listing to ensure the items you requested are properly completed. File the return copy in the "invalidated election" file located in TRS. Proceed to step (10).

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10. The return with the invalidated election must go to the field. Complete form FTB 7024, Request for Field Action, items 1 through 8.

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## 13070 REPORTING - WATER'S-EDGE ELECTION PRE-1994

Pre-1994 water's-edge database is maintained on PCs * * *

BES accepts the election fee amount from the form 100-FEE, as filed. If the fee amount on the form 100-FEE differs from the amount on the form 100-FEE-A, BES will make a copy of the form 100-FEE, which indicates the fee amount accepted, and will attach it to the return.

If the election fee (Field 9 above) differs from that indicated on form 100-FEE-A or no form 100-FEE-A is attached to the return, route the return to BES. Request a copy of form 100-FEE and attached it to the return.

The form 100-FEE-A should not be removed from the return. If you find a form 100-FEE-A in the file maintained in BES, re-attached it to the return.

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## 13090 WATER'S-EDGE - FOREIGN PARENT LIST

TRS is no longer updating the Foreign Parent list for taxable years beginning after 1994. However, information from the list for taxable year beginning on or before 1994 may be obtained from TRS.

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## 13100 WATER'S-EDGE - BOX CHECKER RETURNS - BACKGROUND

"Box Checker" returns are defined as pre-1994, 1997-1999 forms 100 and 100S filed by general and apportioning corporations in which the taxpayer has incorrectly marked the water's-edge box indicating they are filing on a water's-edge basis when they in fact have not entered into a water's-edge contract.

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## 13110 SUPPORT STAFF - PROCESSING WATER'S-EDGE FIRST-YEAR RETURNS

Under the direction of a Technical Resource Section (TRS) specialist assigned the water's-edge (WE) contract review function, the following tasks are performed by TRS support staff:

1) THE FOLLOWING APPLY TO TAXABLE YEARS BEGINNING ON OR AFTER 1994:
   a) Review WE contracts involving one taxpayer.
   b) Process WE contracts through BETS * * * * * * * * * * *.
   c) Refer all WE contracts involving more than one taxpayer or problem contracts to the TRS specialist assigned to the WE contract review function.
   d) After reviewing a contract, make a copy for the retention file. File in alphabetical order.
   e) Check for first-year contracts.
   f) All returns are sent to Data Services.
   g) If a water's edge election is invalidated, make copies of the entire return for the retention file.
   h) If a contract is not in BETS, add the contract information using * * * * * * * * *.
   i) Request returns from Data Services as needed.

   <u>Any Contract problems should be brought to the attention of TRS.</u>

2) NOTICE OF NONRENEWAL (FORM 1116)
   a) Check for Notices of Nonrenewal. If found, ensure it is processed through BETS * * * * * * * * *.
   b) Make a copy of the notices for the retention file. The original Notice of Nonrenewal stays with the original files.

3) DOMESTIC DISCLOSURE SPREADSHEET (DDS) LISTING
   Revenue and Taxation Code §25401(d) required the filing of a DDS for certain banks and corporations electing to file on a WE basis. It was repealed for taxable years beginning on or after January 1, 1994. Revenue and Taxation Code §18634 was enacted effective for taxable years beginning on or after January 1, 1994. This law provided that any taxpayer (not just WE filers) with total worldwide assets in excess of $200,000,000 was required to file an information return, Form 2427, Worldwide Affiliation Schedule. Section 18634 was since repealed for information returns due on or after January 1, 1996. The due date includes any approved extensions to file the information return. Thus taxpayers are no longer required to provide the department with information concerning worldwide affiliates if they file on a WE basis.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 13120 COMPLETION OF FORMS - CANCELLATION OF WATER'S-EDGE PENALTIES

Complete form FTB 5843, Cancellation of Liability, to abate or partially abate WE penalties. Data entered on the form is as follows:

1. Taxpayer's Name
2. Corporation Number
3. Posting Control
4. Taxable year Ended
5. Transaction Date (Effective date of penalty assessed from BETS or the B&C Master File)
6. Revenue Code (Same as the one used to assess the penalty)
7. Penalty Code
8. Cancellation of Failure to Furnish Information
9. Amount of Penalty to be Abated
10. Reason for Cancellation
11. Requester Code and Auditor's Initials
12. Current Date

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## 13130 WATER'S-EDGE FAILURE TO FURNISH INFORMATION PENALTY

R&TC § 25112 provides for the assessment of a failure to furnish information penalty relating to information required of taxpayers filing a WE election. The penalty may only be issued by NPA.

### AMOUNT OF THE PENALTY

Each taxpayer that fails to furnish information described in R&TC §25112(b) within 60 days of a written request, may be assessed a penalty of $1,000 for each taxable year the information was not timely furnished (R&TC §25112(a)).

Each taxpayer that fails to furnish information under R&TC §25112(b) within 90 days of notification by a bureau director or a supervising counsel, will be subject to an additional $1,000 per month (or fraction thereof) not to exceed $24,000 (R&TC §25112(c)).

Effective 1/1/2002, the immediate supervisor's approval is required anytime a failure to furnish information penalty is assessed.

The water's-edge failure to furnish information penalty can be assessed at the same time as other penalties (such as a delinquency penalty) on an NPA.

### NOTICE OF PROPOSED ASSESSMENT

The penalty is assessed on form FTB 6830 BCT NPA Worksheet by entering the following:

(1) Penalty Description - WE-INFO PEN
(2) Amount of Penalty
(3) NPA Paragraph

Interest is assessed from the date of the NPA.

### NPA PARAGRAPH

Use this paragraph for initial failure to furnish information penalty:

"In accordance with Revenue and Taxation Code 25112(a), we have assessed a penalty for failure to supply information or documents as required under Section 25112(b). Each taxpayer shall pay a penalty of $1,000 for each taxable year for which the information was not timely furnished."

Use this paragraph for any increase in the penalty for failure to furnish information:

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"In accordance with Revenue and Taxation Code Section 25112(c), we have assessed an additional penalty for failure to supply information or documents as required under Section 25112(b). Each taxpayer shall pay an additional penalty of $1,000 per month for each taxable year for which the information was not timely furnished, not to exceed $24,000 per taxable year."

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## 14000 BANKRUPTCY

MAPM 14010 Bankruptcy Unit
MAPM 14020 Identifying A Taxpayer In Bankruptcy
MAPM 14030 Bankruptcy Types
MAPM 14040 Important Dates & Periods

MAPM 14050 Prior Bankruptcy Law
MAPM 14060 Current Bankruptcy Law
MAPM 14070 Prompt Audit Requests
MAPM 14080 Statute Of Limitations
MAPM 14090 Petition Number
MAPM 14100 Audit Bankruptcy Procedures
MAPM 14110 Application Of Franchise Tax
MAPM 14120 Penalties
MAPM 14130 Tax Notice Procedures-Prior Bankruptcy Law
MAPM 14140 Tax Notice Procedures-Current Bankruptcy Law
MAPM 14150 Post NPA - Out Of State Protest Cases
MAPM 14160 Tax Notice Worksheet (NPA, NOA NOD)
MAPM 14170 Bankruptcy Correspondence - Protested NPAs, Other Non-Final NPAs
MAPM 14180 Bankruptcy Correspondence - Final NPAs
MAPM 14190 Combined Report Procedures

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## 14010 BANKRUPTCY UNIT

Auditors may contact the Bankruptcy unit with questions regarding pending audits on bankrupt debtors or to obtain advice from the Bankruptcy unit staff about case information about pending assessments and other issues.

The Bankruptcy Unit in the Special Procedures Section of the Special Programs Bureau coordinates all bankruptcy actions. The unit files claims with the Bankruptcy Court, advises other units on bankruptcy procedures, provides training, and coordinates activities between our employees, the Attorney General's Office, and taxpayers on bankruptcy matters. The Bankruptcy Unit is responsible for the collection of amounts owing from taxpayers that have filed for bankruptcy protection.

This section contains answers to questions such as:

- When can an auditor issue an NPA, if the taxpayer has filed for bankruptcy?
- Should an NPA be issued on federal audits that are not final and/or agreed?
- Can the auditor issue an O/A (refund)?
- What effect does the issuance of an NPA or refund have on the bankruptcy or FTB's ability to collect?
- If a taxpayer tells us they are bankrupt but does not provide any details and bankruptcy information is not located, how should staff proceed with the audit?
- How much authority does a trustee have? How should the auditor proceed? Should you request a power of attorney from the trustee?

A number of terms have specific and significant meaning that must be understood when working with a taxpayer in bankruptcy. A brief definition is included below, however, it is very important that you read all of the information contained in this section in order to understand which actions are prohibited to FTB.

| | |
|---|---|
| **Automatic Stay** | When a bankruptcy petition is filed on a corporation, an automatic stay is imposed immediately. It prohibits creditors, or potential creditors, from making demands on the corporation in bankruptcy. |
| **Bar Date** | Last date when FTB can file a claim with the bankruptcy court for taxes due on income earned prior to the **petition** date. |
| **Confirmation Date** | The date the Chapter 11plan is approved by the bankruptcy court. |
| **Petition Date** | The date a Petition for Bankruptcy is filed with the court. |

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## 14020 IDENTIFYING A TAXPAYER IN BANKRUPTCY

The Bankruptcy Unit will monitor all Chapter 7 and Chapter 11 accounts.

The Bankruptcy Unit receives petition information from the California courts and uses this information to place certain codes on the taxpayer's account. If the corporation files for bankruptcy in a court outside of California, the FTB will be notified only if it is listed as a creditor. Once the Bankruptcy Unit receives information that a corporation is in bankruptcy, it will prepare form FTB 6631, Corporation Bankruptcy Claim Worksheet. This form lists the bankruptcy information and the bar date if one is set. This form is placed in the corporation folder.

When entering bankruptcy codes on corporation system files, the Bankruptcy Unit may not be aware an audit is in progress. Therefore, when working any audit case, keep in mind the potential for bankruptcy. How often the system should be checked is a matter of judgment. Particular weight should be given to the amount of revenue involved and any other information the auditor has regarding a taxpayer's financial condition.

### BUSINESS ENTITY TAX SYSTEM

**BETS** - * * , the NPA case detail screen will show a "HOLD" status, and assigned to 199 BKY, for prior 10/22/94 Bankruptcy Law only. * * will provide the Bankruptcy information, chapter filed (7 or 11) and petition date. * * may contain notes regarding the Bankruptcy.

### IDENTIFICATION DURING AUDIT PROCESS

If a taxpayer does not inform the auditor of their intention to file for bankruptcy, the following are some indicators that can help to identify a potential bankruptcy situation:

- Negative cash flow or cash flow problems
- Change from profit to loss on tax returns
- High debt to equity ratio
- Large adverse litigation judgements
- Significant drop in the price of stock
- Substantial under-funding of pension plan
- Major management shakeups
- Foreclosure proceedings
- Retention of bankruptcy counsel
- Representative complaining of nonpayment
- Negative reports or publicity

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- Hiring of a "turnaround specialist"

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## 14030 BANKRUPTCY TYPES

### CHAPTER 7 LIQUIDATION

In Chapter 7 liquidations, an estate is created, and a trustee is assigned by the court to collect and liquidate all non-exempt assets. A bar date is established usually 90 days after the first meeting of creditors. Once the estate is liquidated, the trustee distributes the estate's proceeds to creditors according to priority. A discharge order is not entered because the entity ceases to exist.

### CHAPTER 11 REORGANIZATION

In Chapter 11 reorganizations, the debtor is given protection from creditors to develop a reorganization plan to repay debts. The debtor attempts to workout agreements with creditors to remain in business. It allows for 100% payment of some creditors' claims but less than full payment for others. All claims are paid according to a reorganization plan that is approved by a majority of the creditors. The court determines the bar date.

### AUDITS AND BANKRUPTCY

Audits involving taxpayers that have filed for bankruptcy protection require special handling. There are two principal issues of concern when a taxpayer files a bankruptcy petition:

1. The state's interest must be protected by filing claims prior to the bar date.
2. The taxpayer's rights must be protected with regard to the "Automatic Stay."

When a corporation files a petition for bankruptcy, additional dates come into play that will bar the assessment of additional tax regardless of whether we have a waiver signed. Therefore, once an auditor becomes aware that a corporation has filed a petition for bankruptcy, a decision must be made to either survey all open years, or to expedite the audit of all open years.

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## 14040 IMPORTANT DATES & PERIODS

### PETITION DATE

The petition date is the date a Petition for Bankruptcy is filed with the court.

### BAR DATE

The bar date is the last date in which FTB can file a claim with the bankruptcy court for taxes due on income earned prior to the petition date. (Pre-petition years plus the short income period ending on the petition date). If a timely claim is not filed, then the department may be barred from collecting past taxes including pending assessments. For audit purposes, the bar date is of great concern since it may be considered as the statute of limitations date.

### THE BAR DATE RULES FOR CORPORATIONS

1. The bar date is the last day for creditors to file claims against a debtor in a bankruptcy case.

   For audit purposes the bar date becomes our statute date. The bar date does not extend the audit time limit and does not extend the SOL under the California Revenue and Taxation Code. (See **MAPM 14080** on SOLs for bankruptcy cases.) The Bankruptcy Unit must be informed well in advance of the bar date of any pending assessment to allow sufficient time for filing claims in bankruptcy court for taxes owed.

2. For a Chapter 7 bankruptcy case which began prior to October 22, 1994, there is no bar date for priority claims (e.g., taxes owed) following court cases for the period prior to the Chapter 7 petition date. Refer to the following court case: Pacific Atlantic Trading Co., U.S. Court of Appeals for the Ninth Circuit, August 18, 1994. However, the auditor should call the Bankruptcy Unit for advice before assessing tax on "NO ASSET" Chapter 7 cases. The bankruptcy case could change from a "NO ASSET" case to an "ASSET" case. Once a Chapter 7 corporation liquidates, the debt is not collectible even though the debt is not discharged by the Bankruptcy Court.

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3. Normally the Chapter 11 bar date becomes null and void if a bankruptcy case is converted from Chapter 11 to Chapter 7. If the SOL period has not expired, we may assess tax on the pre-chapter period while the Chapter 7 case is still open, assuming it is an "ASSET" case.

4. If the Bankruptcy Unit receives notification that a Chapter 11 case has converted to a "NO ASSET" Chapter 7 case, they will suspend the taxpayer and do an in-house discharge of all account balances.

5. If a Chapter 7 or Chapter 11 bankruptcy case is dismissed by the Bankruptcy Court, the bar date is null and void for that case. The department may then treat the taxpayer as any other taxpayer.

**CONFIRMATION DATE**

The confirmation date is the date the Chapter 11 plan is approved by the bankruptcy court.

**AUTOMATIC STAY**

When a bankruptcy petition is filed on a corporation, an automatic stay is imposed immediately. The automatic stay prohibits creditors, or potential creditors, from making demands on the corporation in bankruptcy. The automatic stay can prevent further collection action and also prohibit the department from demanding audit information for the duration of the bankruptcy proceedings. An auditor must be careful not to violate the automatic stay when requesting audit information. The auditor may request information but cannot impose penalties for non-response. If the taxpayer does not provide the information, the auditor should inform the taxpayer in writing of our intention to issue an assessment. Issue the assessment following the procedures in **MAPM 14100**. The automatic stay has different limitations on FTB's actions depending on the date the bankrupt corporation filed the bankruptcy petition as follows:

**WHEN THE BANKRUPTCY PETITION IS FILED <u>PRIOR TO</u> OCTOBER 22, 1994:**

1. The automatic stay prohibits the department from taking the following actions:

   Issuing Demand Letters
   Levying the Taxpayer's Account
   Billing the Taxpayer
   Issuing Notices of Action, Notices of Revision, Notices of Determination
   Placing Liens on Assets

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Issuing Jeopardy Assessments (unless given permission by the taxpayer)
Finalizing NPAs
Issuing Subpoenas

2. With the taxpayer's permission, auditors may continue the following:

   - Making Audit Inquiries (no demands)
   - Placing Telephone calls
   - Issuing Information Document Requests

3. NPAs may be issued while the taxpayer is in automatic stay, but flag the NPA with bankruptcy code 199 BKY immediately to ensure it does not go final. (See **MAPM 14100**, Item 2) The importance of contacting the Bankruptcy Unit cannot be overemphasized.

**WHEN THE BANKRUPTCY PETITION IS FILED <u>ON OR AFTER</u> OCTOBER 22, 1994:**

1. The automatic stay prohibits the department from taking the following actions:

   - Issuing Demand letters
   - Levying the Taxpayer's Account
   - Placing Liens on Assets
   - Issuing Jeopardy Assessments (unless given permission by the taxpayer)
   - Issuing Subpoenas
   - Sending Bills Threatening Involuntary Collection Action
   - Taking Involuntary Collection Action

2. With the taxpayer's permission, auditors may continue the following:

   - Making Audit Inquiries (no demands)
   - Placing Telephone Calls
   - Any Audit Information Requests

3. Auditors may do the following:

   - NPAs may be issued while the taxpayer is in automatic stay and NPAs can go final.
   - Issue NPAs, NORs or NODs.

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- Issue standard bills that do not threaten involuntary collection actions.
- Demand the filing of income tax returns.
- Perform normal audit activity including issuing IDRs (but not demands for information).

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## 14050 PRIOR BANKRUPTCY LAW

For those corporations whose bankruptcy petitions were filed prior to October 22, 1994, a tax notice could not be finalized while the taxpayer was in bankruptcy. Refer to the following court case: Schwartz vs. United States, U.S. Court of Appeals for the Ninth Circuit, January 22, 1992. Under these conditions, finalization of a tax notice (NPA, NOA, and NOD) would be a violation of the automatic stay provisions of the bankruptcy law.

Therefore, check with the Bankruptcy Unit's advisor for those cases subject to prior law before issuing NPAs to see if the 199 BKY hold procedure should be used. (See **MAPM 14100**) Also check with the Bankruptcy Unit for those cases subject to prior law before issuing finalized notices (NOAs and NODs) or allowing an NPA to go final.

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## 14060 CURRENT BANKRUPTCY LAW

The Bankruptcy Reform Act of 1994 is applicable for those corporations filing bankruptcy petitions **on or after** October 22, 1994. Changes made to the Bankruptcy Code by the Act are as follows:

1. Section 362(b)(9) of the Bankruptcy Code expanded the exception to the automatic stay provisions for governmental units. The new provision allows governmental units to issue a finalized notice of tax deficiency, make a demand for tax returns, assess any tax and issue a notice for payment of tax assessed.
2. Section 502(b) of the Bankruptcy Code provides that a claim of a governmental unit is considered timely filed if it is filed before 180 days after the date of the order for relief (petition date) or such later time as the Federal Rules of Bankruptcy Procedure may provide. (For audit purposes no more than 120 days from the petition date will be used to complete the audit. This allows the Bankruptcy Unit 60 days to file a claim with the Bankruptcy Court.)

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## 14070 PROMPT AUDIT REQUESTS

Bankruptcy Code Section 505(b) provides that a trustee of a bankruptcy estate can avoid personal liability by requesting a prompt audit of tax returns filed under the trustee's administration of the bankruptcy estate. The FTB has 60 days from the date the trustee's letter is received to notify the trustee that an audit is being initiated on specified tax years. After 60 days, the SOL period to audit the returns for the specified tax years filed during bankruptcy proceedings is considered expired. If a timely examination is performed, FTB has 180 days from the date the request is received to complete the audit and notify the trustee of any tax due. Otherwise, FTB loses the SOL period for assessing tax after the 180-day period has run.

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## 14080 STATUTE OF LIMITATIONS

For audit purposes, the SOL for assessing tax is the **earliest** of:

- The SOL period under the California Revenue and Taxation Code
- The bar date under the Bankruptcy Code (**MAPM 14040**)
- The time limits specified under the prompt audit request provisions of the Bankruptcy Code (**MAPM 9000 and MAPM 14070**.)

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## 14090 PETITION NUMBER

The Bankruptcy Petition Number provides important information. An example follows:

Case Number 1-90-12345-DM

| | | |
|---|---|---|
| 1 | = | court number |
| 90 | = | year filed |
| 123 | = | petition number |
| 45 | | |
| DM | = | *Usually the last 2 digits are the judge's initials. In this case, the DM stands for Judge Doug Miller (for example). |

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## 14100 AUDIT BANKRUPTCY PROCEDURES

If during the course of an audit, it is discovered that the taxpayer is in bankruptcy, certain procedures must be followed. The auditor should check the account to see if the account is coded bankrupt. If not, the auditor should obtain the bankruptcy documents from the taxpayer or directly from the **court computer** (see below) with the following information:

- Name (exactly as shown on bankruptcy petition)
- Bankruptcy Number (Petition Number)
- Date Petition was filed
- Chapter Number (7 or 11)
- Bar Date
- Court District
- If out of state, the exact court address.
- Name, address, phone number and fax number of Attorney/Trustee
- Date of first meeting of creditors
- Date Discharge of Debtor is granted

These documents, once received, should be routed to the Bankruptcy Unit so the account can be coded. The auditor should retain a copy for the audit file.

Auditors should be most concerned with the bar date, since this date is considered to be the SOL date for state purposes. If the bar date is not available in the file, the Bankruptcy Unit can obtain this date or verify if such a date has been set. If a Bankruptcy advisor finds that an NPA needs to be withdrawn because it was issued after the bar date, they will contact the maker of the NPA to have them withdraw the NPA.

**Court Computer -** It is possible to obtain information via the VCIS system. The Voice Case Information System (VCIS) is information read directly from the court computer. It will provide: Case Number, Name (s) of Debtor (s), Petition Date, Chapter, Attorney Name and phone number, Judge's Name, Discharge Dates, First Meeting of Creditors date and time, Case Status and whether or not there are assets. If you are reading this document on-line, you simply click on the hyperlink included below and select Court Trustee Phone numbers and click under United States Bankruptcy Courts of California to see the phone number for the specific area and the instructions.

* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * *

## PRIOR TO BAR DATE

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### NPA is in the review process

Sometimes an auditor may hear of a bankruptcy after an audit has been submitted for review, but before the final NPA has been issued to the taxpayer. In this situation, the auditor should notify the Bankruptcy Unit that an NPA is pending. The FTB may need to file a claim with the bankruptcy court before the NPA completes the review process and posts to the system.

### Decision whether to issue provisional assessment

If the taxpayer that filed bankruptcy is currently under audit, the audit should be expedited. The auditor should seek the taxpayer's cooperation in rapidly concluding the audit so that accurate figures can be used in issuing an NPA and the Bankruptcy Unit can file a claim.

If the taxpayer does not wish to expedite the audit, NPAs must be issued based upon available information. A claim for additional tax for pre-petition years must be filed with the bankruptcy court by the bar date to be paid from the estate. Once filed, the claims can be amended later if it is determined that the original proposed assessments should be adjusted. Claims for the additional tax for the post-petition period through the confirmation date must be filed by the confirmation date. No demand penalties may be assessed while the taxpayer is in bankruptcy and protected by the automatic stay. All other penalties may be assessed if applicable.

## JEOPARDY ASSESSMENTS

"Jeopardizing" an assessment makes the assessment immediately due and payable, which creates a statutory lien and allows immediate collection action. The primary consideration for issuing a jeopardy assessment is whether there is risk of not collecting the amount due unless immediate collection action is taken. A jeopardy assessment cannot be issued while a taxpayer is in bankruptcy, however, if there are indications that the corporation may file bankruptcy, jeopardizing, an assessment may be necessary. See **MAPM 6080** for instructions on issuing a jeopardy assessment. Contact the Bankruptcy Unit for advice on issuing a jeopardy assessment.

## DISCHARGE OF B & C TAXES

### Chapter 7

Corporations are not granted a discharge by the court under a Chapter 7. However, since all assets are liquidated, any liabilities not paid through the claims process are effectively discharged. And, since the corporation has ceased to conduct business, generally, it is not subject to post-petition taxes. Therefore, an NPA must be issued so that related claims can be filed prior to liquidation of assets.

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**Chapter 11**

If a debt is to be paid as part of the reorganization plan, it will be paid at the amount and priority listed. When the Order Confirming the Plan for Reorganization is issued by the court, the corporation is discharged from all debts that arose before the confirmation that is not paid out of the plan. Post-confirmation debts are not discharged. Therefore, NPAs for years ending after the confirmation date may be issued and allowed to finalize during the life of the plan.

**POST BAR DATE**

There are instances where a claim can be filed after the bar date and paid through the bankruptcy or an NPA can be issued and is collectible after the automatic stay is lifted.

**Chapter 7**

A recent court decision, known as the PATCO case, allows FTB to file priority claims (only includes tax, interest on tax, and estimate penalties) after the bar date until the estate is closed. Once the estate is closed, there is no collection means available to FTB and audits should not be done. PATCO applies only to pre-reform (10/22/94) estates.

**Chapter 11**

Often Chapter 11 cases convert to Chapter 7. This will create a new opportunity to file a claim.

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## 14110 APPLICATION OF FRANCHISE TAX

Corporations that file Chapter 7 will liquidate. These corporations are not subject to minimum franchise tax after the petition date. These corporations only become subject to tax if there is positive income during the entire administrative period (petition date to final liquidation), which is uncommon. Corporations under Chapter 11 are still going concerns and continue to be subject to the minimum franchise tax. If the bankruptcy case converts to Chapter 7, the corporation is no longer subject to the franchise tax from the conversion date forward.

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## 14120 PENALTIES

Audit can assess all applicable penalties except failure to furnish information on Chapter 11 bankruptcy corporations. The most commonly assessed penalties are the delinquent filing and estimate tax penalties.

Penalties should **not** be assessed on a Chapter 7 bankruptcy corporation.

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## 14130 TAX NOTICE PROCEDURES - PRIOR BANKRUPTCY LAW

**THE FOLLOWING PROCEDURES APPLY TO BANKRUPTCY PETITION DATES PRIOR TO OCTOBER 22, 1994.**

1) Contact the Bankruptcy Unit for current bankruptcy status in order to determine whether a notice (NPA, NOA, NOD) should not go final pending the bankruptcy outcome. (Generally a notice should not go final during bankruptcy proceedings if the bankruptcy petition date is prior to October 22, 1994, and the Bankruptcy Court has not given the taxing authority approval to finalize the tax notice.) Only the Bankruptcy Unit should make the determination.
2) If the Bankruptcy Unit indicates that a "hold" should be placed on the account to keep an NPA from going final, form FTB 7068 (Bankruptcy Special Handling) is attached to the NPA worksheet. This is a small green tag and the bankruptcy petition date is to be written on this tag. This tag will alert the Protest Control Desk to put a 199 BKY hold status on BETS, * * to prevent the NPA from going final. For BETS issued notices, attach form FTB 7068 to the front of the file folder.
3) The 199 BKY hold status cannot be released by Audit on non-final notices because the finalization of the notice would violate the automatic stay provisions.
4) If the NPA was protested and the Bankruptcy Unit indicates that an NOA/NOD should not go final pending the bankruptcy outcome, auditors can still attempt to resolve all audit issues but the bankruptcy issue, by following the normal unit procedures except:
   a) The NOA or NOD can be issued, if it is a withdrawal, because it would not violate the automatic stay provisions of the Bankruptcy Code.
   b) Audit should complete the NOA/NOD worksheet to show the adjustment that ultimately will be made. Apply the bankruptcy procedures listed in **MAPM 14160**. Make a photocopy of the worksheet and send it to the Bankruptcy Unit so that they are notified of the action that will be taken.
   c) Once the bankruptcy proceedings are finalized, the Bankruptcy Unit will notify the maker of a protested NPA to issue the formal NOA/NOD.

      Audit will request the folder from DSS.

      Upon receiving the folder, check it for completeness (i.e., correct

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address and copies of tax notice worksheets).

Audit should follow normal procedures for issuing an NOA/NOD; however, apply bankruptcy identification procedures listed at **MAPM 14180**.

Audit will then send the NOA/NOD worksheet or the BETS Batch Information and the corporation folder to Business Entities Clerical Support (BE Clerical Support) for processing. After batch processing, a copy is given to the Protest Control Desk to update BETS, * * .

5) If the Bankruptcy Unit indicates that a hold code should **not** be placed on the account to keep an NPA from going final, do not attach the form FTB 7068. Follow normal unit procedures for issuing notices.

6) With regard to non-protested NPAs, when the Bankruptcy Unit receives notification from the Bankruptcy Court that the case has been discharged, dismissed, or closed, the Bankruptcy advisor will notify the Protest Control Desk to handle all "HOLD" releases with BETS.

**(See MAPM 14160, for tax notice worksheet instructions.)**

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## 14140 TAX NOTICE PROCEDURES-CURRENT BANKRUPTCY LAW

**THE FOLLOWING PROCEDURES APPLY TO BANKRUPTCY PETITION DATES <u>ON OR AFTER</u> OCTOBER 22, 1994:**

1) NPAs may go final while the taxpayer is in bankruptcy if the bankruptcy petition date is on or after October 22, 1994. There is no need to put a 199 BKY hold status on BETS to prevent notices from going final.
2) If in protest, resolve all issues other than the bankruptcy issue by following normal unit procedures. Protested and non-protested notices can be adjusted during the bankruptcy period. However, automatic stay provisions still prevent auditors from issuing demands for information. (See **MAPM 14040**)
3) After audit has made its determination on protested NPAs and has made all the required adjustments, it should apply the bankruptcy identification procedures listed in **MAPM 14160**, so that the Bankruptcy Unit is notified of the action taken.

**(See MAPM 14160 for instructions on how to proceed.)**

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## 14150 POST NPA - OUT OF STATE PROTEST CASES

The Protest Unit (392:Pro) will periodically generate a listing for the Bankruptcy Unit. The Bankruptcy Unit will let the Protest Unit know if anyone on the list has been discharged from bankruptcy, so action can be taken on the protest.

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## 14160 TAX NOTICE WORKSHEET (NPA, NOA NOD)

1) The following bankruptcy information should be included on the worksheet:
    a. For ALL notices use NPA paragraph 50500 modified by adding the bankruptcy petition date and bar date.
    b. CC: Collection Special Procedures - Bankruptcy Unit
    c. Attach a form FTB 7011, pink RUSH tag. Mark the bankruptcy box.
    d. On the front cover of the folder attach a route slip with the Bankruptcy Unit as destination.
    e. Attach form FTB 6074, Bankruptcy Case-DO NOT PURGE FOLDER to the inside front-cover of the folder.
2) After preparing the worksheet, route it and the folder to BES Audit Technical Support.
3) After BES processes the notice, it sends a copy to Protest Control Desk to update BETS. BES will route the corporation folder and carbon copy of the notice to the Bankruptcy Unit.
4) Once the bankruptcy proceedings are finalized, if there are any changes needed on the notice, the Bankruptcy Unit will route this information to the maker for revisions.

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## 14170 BANKRUPTCY CORRESPONDENCE - PROTESTED NPAS, OTHER NON-FINAL NPAS

1) Forward any correspondence received on any notice to the Protest Control Desk for review.
2) Other non-final correspondence will be forwarded to the maker of the notices by Protest Control Desk for evaluation.
3) If the taxpayer uses bankruptcy as a basis for protest, the Protest Control Desk will include the following in its reply to the taxpayer: "The bankruptcy petition is not a basis for protest". Protest Control Desk will forward the folder and correspondence to the maker for further analysis.

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## 14180 BANKRUPTCY CORRESPONDENCE - FINAL NPAS

1) In cases where correspondence comes in after the notice has gone final and the taxpayer is claiming bankruptcy, send a copy of the notice and the taxpayer's correspondence to the Bankruptcy Unit to determine whether abatement is necessary. Audit may be asked to re-issue notices if the SOL is open.
2) If the audit and/or collection issue can be resolved by adjusting the account, the maker should complete form FTB 6213A Accounting Instruction worksheet showing the proper adjustments and tax effect. Audit should route a copy of the 6213A with the corporation folder to the Bankruptcy Unit. An amended Bankruptcy claim may be required.
3) If the Protest Control Desk receives correspondence regarding protested notices, the correspondence will be forwarded to the maker of the notice for further analysis and response.

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## 14190 COMBINED REPORT PROCEDURES

Notices of deficiency or overassessment on corporations subject to combined reporting may require the use of intrastate apportionment if one or more corporations are in bankruptcy. Check with your lead auditor or supervisor for further guidance.

If you have read this section and have not found the answer to your question, you may access the Special Procedures Bankruptcy site that contains Auditor Bankruptcy Training information. * * *

# 15000 POST DISSOLUTION/TAX CLEARANCE

MAPM 15001 Post-Dissolution /Tax Clearance
MAPM 15010 Post-Dissolution General
MAPM 15020 Audit Control Of Dissolved Corporations
MAPM 15030 Related Folders Missing
MAPM 15040 Processing Folders
MAPM 15050 Latest Return Not In Folder
MAPM 15060 Returns In Field
MAPM 15070 Requesting Corporate Folders
MAPM 15080 Dissolution Of A Credit Union
MAPM 15090 Reorganizations
MAPM 15100 Filing Requirements For A Merger
MAPM 15110 Processing Final Return
MAPM 15120 Dissolved Parent Or "Key" Corporation
MAPM 15130 Computation Of Final Tax (§23151.1)
MAPM 15140 First Year Tax Credit
MAPM 15150 Refunds
MAPM 15160 Audit Issues
MAPM 15170 Deferred Installment Sale Income
MAPM 15180 Accounts Receivable
MAPM 15190 Gain On Distribution Of Assets
MAPM 15200 Subchapter S Corporation
MAPM 15210 Bad Debt Reserve
MAPM 15220 Net Operating Loss
MAPM 15230 Definitions

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## 15001 POST-DISSOLUTION /TAX CLEARANCE -IN GENERAL

Before a corporation can be dissolved, surrendered, or merged from California, it must file the proper documents with the Office of the Secretary of State and with the Franchise Tax Board to receive a Tax Clearance Certificate. For more information refer to FTB Publication 1038, Instructions for Corporations Requesting a Tax Clearance Certificate. * * * * * * * * * * * * * * * * * * * * *

In accordance with the law, FTB has 30 days after receipt of the request in which to notify the person requesting the certificate that further action is necessary. A corporation may request a tax clearance certificate based on the following:

- Assumption of Liability: an individual or another corporation agrees to assume any future tax liabilities of the entity that is ceasing its existence.
- Final Return/Taxes Paid Basis: the returns are audited immediately and the tax clearance certificate is issued only after all audit issues are resolved and/or balances due are paid.
- Surety Bond or Cash Deposit: the corporation will post a bond or make a cash deposit. FTB will release the bond or refund the cash deposit after the Post Dissolution Audit Team determines that there is no tax liability. The audit is generally completed within one year after the formal dissolution. The minimum amount of a bond or deposit is $2,000.

For those corporations requesting a tax clearance certificate under any of the methods other than the Taxes Paid Basis, the account is reviewed at the time of the request. If the corporation is current with filing their tax returns and does not have a liability, a tax clearance certificate will be issued immediately. * * * * * * * * * * * * * * * * * * *

MSA Central Office receives tax clearance boxes, in which the corporation has requested a tax clearance based on a taxes paid basis. These requests are forwarded to MSA Central Office to be scoped for possible audit issues and should be returned to the Tax Clearance unit within a week or two of assignment. Items to take into consideration are:

1. Check the box to make sure all corporation folders listed on the cover sheet are in the box. If a folder is missing or additional folders are in the box, make a note of this on the cover sheet.

2. Review Folder to make sure that all corporation tax returns are available for scoping (Check BETS and PASS). The Tax clearance unit should only refer corporations where all the returns are in the folder. If not,
   - Review the tax clearance correspondence for the date the business ceased or will cease to do business in California. This will be the last tax return to be filed.
   - Check to see if a copy of the return is attached to the tax clearance correspondence. If so, verify net income and tax against BETS.
   - Check with Data Services & Storage or PASS to locate any missing returns.

3. Organize the contents of the file. Put returns in tax year order to determine if any years are missing. The Tax Clearance correspondence and loose paperwork should be arranged in chronological order and stapled together with the Tax Clearance correspondence on top. The Tax Clearance package should be placed in front of the folder.

4. Scope all OPEN year corporation tax returns for audit issues. * * *

- Built in Gains tax (Subchapter S Corporations) – When an S Corporation sells or distributes property in liquidation, the gain may be subject to a higher tax rate. Also, gains may be taxable to the shareholder.
- Bad Debt Reserve (Financials) – If an account is received by the corporation through the sale or other disposition of its A/R, in excess of their "net tax basis", such income is taxable in the last year that the corporation is subject to tax.
  - Net Operating Loss – Corporation's frequently claim 100% of losses when only 50% are allowable. They also forget previously ineligible NOLs expire before the normal 5 years, and new ESB guidelines only apply to corporations with losses after 01/01/94.

6. Completed Folders - Corporation folders that were reviewed and surveyed - * * *

## 15010 POST DISSOLUTION GENERAL

Qualified corporations must formally dissolve or withdraw through the Secretary of State. To do this all returns must be filed and taxes paid.

After a corporation has formally dissolved through the Office of the Secretary of State, a magnetic tape is sent from the Secretary of State reporting all the newly dissolve corporations. FTB runs this tape periodically against BETS and updates the corporation's status * * * * * * * * * *. A quarterly BETS report (Dissolved Corp List) is generated that reports all newly dissolved corporations. This list is used by the lead auditor to request the work from DSS.

Data Services personnel also use this list to pull the folders of dissolved or withdrawn corporations from the active files. They process the folders by stamping the date of dissolution in the "PD Audit" box on the face of the folder. The folders are routed to Audit at the request of the post-dissolution lead auditor approximately nine to 12 months after dissolution or withdrawal.

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## 15020 AUDIT CONTROL OF DISSOLVED CORPORATIONS

When the folders of dissolved corporations are received, the auditor/tax technician assumes full responsibility for control of the folder by entering their initials in the "PD Audit" box of the folder. Upon completion of the audit, the auditor/tax technician initials and dates (mm/yy) the top of the "PD Audit" box. Any folder received by Data Services with an open "PD Audit" box will be forwarded to the Post-Dissolution Unit for appropriate action.

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## 15030 RELATED FOLDERS MISSING

Before any audit action is taken, folders for all related corporations that are dissolved should be requested so that the entire file can be audited at the same time. If the tax clearance worksheet indicates multiple clearances were issued, check the following sources for the names of the related corporations:

- Correspondence attached to the tax clearance
- Assumption of Liability
- Dissolving corporation returns
- The PASS System

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## 15040 PROCESSING FOLDERS

The contents of the folder should be arranged in proper order to identify any missing items.

The Tax Clearance correspondence and loose paperwork should be arranged in chronological order and stapled together with the Tax Clearance Certificate on top. The Tax Clearance package should be placed in front of the folder. The determination made ("Reorganization"/"No Reorganization") must always be shown on the upper right corner of the tax clearance certificate.

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## 15050 LATEST RETURN NOT IN FOLDER

Review the account to determine if all returns have been filed.

If the latest return is not in the folder:

(1) The folder may be retained by the auditor and form FTB 6237 (Request for Corporation Folders) used to request the missing return, or
(2) Send the folder back to Data Services to wait for the return to be filed.

If the latter method is used, control of the case is maintained by using the tickler control (Form FTB 6216). In order for Data Services to process tickler follow-ups (Form FTB 6216) efficiently, the following procedures have been established:

1) Check the "Pull Folder" box and mark "PD" by the "Pull Folder" box.
2) When writing the tickler pull date, use dashes (- -) instead of slashes (/).
3) Enter the corporation's name and number.
4) In the open year's field, list all of the open years needed to complete the audit. Circle, in red, the years that are missing.
5) Enter 68/(your initials)
6) Enter the current date.

Obtain a magenta flag (* * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * ), and:

1) Staple the magenta flag to the inside of the back cover of the corporate folder.
2) On the magenta flag, list the years of the missing returns.
3) Write the corporate number on the magenta flag.
4) If the missing year is the final return, enter the Document Locator Number (DLN) next to the missing year on the flag.

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If the corporation account discloses that the required return has not been filed:

1) Review the tax clearance correspondence. If the Tax Clearance unit has requested a “balance due” payment, the corporation has made the payment, and there is a credit on the account, do not request a final return. Issue a supplemental assessment for the amount of the credit.
2) If that situation does not apply, (1) initiate a request for the return or (2) establish a tickler control if it appears that the return will be filed within the normal due date or the extended due date. If the missing return has not been posted within 90 days after the normal or extended due date, initiate a request for the return.

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## 15060 RETURNS IN FIELD

Contact the Field Office Audit Supervisor to determine if a field auditor or the Post Dissolution Unit should conduct the audit. If the audit is to be conducted by the field auditor, send the returns to the field using form FTB 7024 (Request for Field Action). * * * * * * * * * * * * * * * * * * * * Special instructions may be given, if needed.

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## 15070 REQUESTING CORPORATE FOLDERS

Requests should be made in accordance with the following procedure:

| | |
|---|---|
| Rush cases | Folders may be requested by telephone if needed for telephone replies or other priority cases. |
| Special cases | Requests should be made on form FTB 6237 (Request for Corporation Folder) marked "Rush" in red. If Data Services cannot locate the requested folder in files, the requestor will be notified immediately and if further search is required, the requestor will request an outsearch. If more than one corporate folder is needed, a separate form FTB 6237 should be prepared for each corporation and the forms staggered for easy identification. |
| Routine cases | Requests should be made on form FTB 6237. The requested corporations should be listed numerically. If the Data Services cannot locate the folders in file, the request will be returned to the requestor showing out information. If after two requests Data Services is still unable to locate the file the requestor may request an “outsearch.” To request an outsearch you must call the Data Services and give them all the pertinent information. If Data Services is unable to locate the folders by the search date, they will return the request to the requestor as UTL (Unable to Locate). If the folder is still needed, another search date should be provided. If Data Services is unable to locate the folders after the second outsearch, the request will be referred to the Corporation Search Supervisor only if it is imperative that the folders be located. |
| Dead by Merger | The transferee folder should be requested. |

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## 15080 DISSOLUTION OF A CREDIT UNION

The effective date of dissolution for credit unions is the date they file their "Election to Wind-up and Dissolve" (Reg. 23331).

Financial Code §15656 controls and takes priority over §23331 of the Revenue and Taxation Code. Therefore, a credit union should be considered dissolved at the time it files a certificate of election to dissolve. Nevertheless, the credit union still needs to file the final papers of dissolution with the Secretary of State like every other corporation in order to dissolve.

Normally, the credit union or its representative will request a tax clearance certificate or may file a final return indicating dissolution. The tax clearance action will be the same as that of other corporations. However, if an election has already been filed, only the liability that accrued prior to the filing of the election will be required in order to obtain a tax clearance. Even though an election may already have been filed, no action will be taken at this time to remove the taxpayer from our active files. This action will be taken when notification is received on the miscellaneous change list from the Office of the Secretary of State.

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## 15090 REORGANIZATIONS

For taxable years beginning January 1, 1984, §23251 of the California Revenue and Taxation Code has been amended to conform to §368 of the Internal Revenue Code regarding reorganizations.

If all the related folders are at hand and a determination of reorganization cannot be made, complete the audit of all returns in the dead folder and send a letter requesting the information necessary to make a determination.

If problems are encountered while auditing the returns, (1) include these items in a request for additional information, or (2) send the returns to the field with instructions to audit the returns and to determine if a reorganization has occurred.

Since one prerequisite for reorganization is a continuation of the transferor's business, it can be assumed that an inactive corporation will not transfer its assets pursuant to reorganization.

For State purposes, a transfer of assets and liabilities to a corporation that has been granted an exemption from tax under the California Revenue and Taxation Code or the State or Federal Constitutions cannot be a reorganization.

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## 15100 FILING REQUIREMENTS FOR A MERGER

For taxable years beginning January 1, 1984, §23253 of the California Revenue and Taxation Code has been amended to conform to Section 381(b) of the Internal Revenue Code.

Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of Section 368(a)(1), the taxable year of the distributor or transferor corporation shall end on the date of the distribution or transfer.

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## 15110 PROCESSING FINAL RETURN

When the final return with form FTB 6028, Return file flag, is received with the appropriate folder, determine if the return has been properly assessed and whether to audit the return.

Review the final return by:

1. Review the balance sheet. If the balance sheet reports an ending balance, look at assets and liabilities. You may need to request a complete schedule of assets and liabilities distributed in liquidation to determine the disposition of assets that are likely to appreciate such as land, buildings, or investments. Remember to ask for the book value and the fair market value of these assets
2. Review accounts receivable. A cash basis taxpayer must report all ending accounts receivable balance into income in the year of dissolution. Therefore, if a corporation had accounts receivable from services completed prior to liquidation, it should be included in income on the corporation's final return. See **MAPM 15180**.
3. Review the final return for deferred income. Unreported income from an installment obligation must be included in income for the corporation's final year. See **MAPM 15170**

When the return has been audited, discard the form FTB 6028.

If there was a tickler control, route the file copy of form FTB 6216 to Data Services with instructions to destroy the tickler copy.

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## 15120 DISSOLVED PARENT OR "KEY" CORPORATION

Whenever the parent or key corporation dissolves or withdraws from doing business in California, the post dissolution auditors will bring the cross referencing up to date as well as the audit. If the key corporation in California is dissolved or withdrawn, a letter should be written to the parent inquiring as to which California subsidiary is to be designated the key corporation.

Usually when the parent dissolves or withdraws from California, it is due to a reorganization; and, the auditor should find the new parent for cross-referencing purposes. However, if the dissolved or withdrawn parent previously made an election to file a single return and pay the tax for a unitary group, the auditor must write and ask the new parent to file an election form FTB 4523B, Authorization For Single Notices, if it wishes to continue to file in the same manner. See MAPM 7090

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## 15130 COMPUTATION OF FINAL TAX (§23151.1)

California Revenue and Taxation Code §23153 states in part that "Every corporation is subject to the minimum franchise tax from the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal from the Office of the Secretary of State, or if later, the date the operation ceases to do business within the limits of this state". The corporation must pay the minimum tax for every year or part year that they exist, whether or not they are actively conducting business.

Corporations must dissolve or withdraw and receive a final certificate of dissolution/withdrawal from the Office of the Secretary of State. The taxable year is terminated at the end of the month of dissolution or withdrawal, and a final return is due two and one-half months later. The tax on the final return is based on the tax measured by net income for the year of dissolution or withdrawal, plus the tax based on net income for the preceding taxable year (but cannot be less than the minimum tax). The tax rate in effect during the month of dissolution/withdrawal is used to measure the final tax.

For financial corporations tax for the year of dissolution is to be computed at the maximum financial rate unless the proper rate has been determined. The full amount of financial offset is allowable, except that the tax may not be less than the tax computed by the general rate or less than the minimum tax.

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## 15140 FIRST YEAR TAX CREDIT

The first year tax credit is applicable only if a corporation commenced doing business in this state before January 1, 1972. The credit allowed is the excess of the tax paid over the minimum tax for the first taxable year that constitutes a full 12 months of doing business.

The first year tax credit is allowed against the final tax. Any excess first-year credit over the final tax is applied to any unpaid liability and the balance refunded to the taxpayer.

R&TC §23202 requires the first-year credit of a transferor in a reorganization to be deferred, and allowed to the transferee at the time it dissolves or withdraws. A corporation filing as an S Corporation is allowed one-third of the first-year credit R&TC §23803.

Any adjustment to the final return or account due to a first-year credit, year change, cancellation, or refund will be made by using form FTB 6213A, Accounting Instructions Corp.

Bank and Corporation Account purge files are located on Microfiche in clerical support section:

Recordax: Alpha – Tax years 1946 – 1968 (tax years in ledger cards 1– 45)
Memorex: 1974 purge – tax years 1968-1972 (1–47 and 1-11)
1977 purge – taxable years 1972-1973 and since 1974 (1-107)

The Record Center has ledger cards back to 1936. To request this information use form FTB 6221. These requests normally take two weeks.

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## 15150 REFUNDS

The auditor may receive folders asking that a determination be made and the amount of tax or payments be refunded when the folder has not been stamped with the "PD Audit" box and date of dissolution. In those cases, where a tax clearance certificate has been issued, access the Office of the Secretary of State's records to find out if the corporation has dissolved. If it has been dissolved, indicate on the tax clearance certificate "Reorg." or "No Reorg." In addition, stamp the front of the folder with the "PD Audit" box. Enter the date of dissolution, your initials, and the date. In the "PD Audit" box, enter the date the audit was completed and your initials.

If the corporation has an overpayment and a claim number has been assigned and a determination has not or cannot be made, send a letter requesting the required information.

Using form FTB 6213A, Accounting Instructions Corp, will make any adjustment to the final return or account due to a first-year credit, year change, cancellation, refund, etc.

Generally, refunds will be based on first-year credit or credit balance from estimated payments.

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## 15160 AUDIT ISSUES

Check ownership information on page 1 of the return, the percent of corporation stock owned on Schedule E, and Compensation of Officers on Schedule E. A review of the balance sheets on all available returns may indicate a change of ownership (i.e., fluctuation of investments in capital stock section).

If the final return indicates dissolution but there is a large net income and/or the balance sheet indicates a large amount of assets and there is no indication of the disposition, initiate an IDR for additional information.

For specific issues, see:

- Deferred installment sale income **MAPM 15170**
- Accounts Receivable **MAPM 15180**
- Gain on Distribution of assets **MAPM 15190**
- Subchapter S Corporations **MAPM 15200**
- Bad Debt Reserve **MAPM 15210**
- Net Operating Loss **MAPM 15220**

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## 15170 DEFERRED INSTALLMENT SALE INCOME

If no reorganization occurred, §24672 of the California Revenue and Taxation Code requires a corporation to include in its measure of tax the unreported income from an installment obligation it holds at the time the corporation is no longer subject to the tax imposed by Chapter 2 or 3.

The installment note's basis is then increased to its face amount pursuant to the acceleration of §24672. In accordance with R&TC §24667 and IRC §453B, the corporation should recognize gain or loss on the difference between the fair market value of the note and its basis.

If a corporation has sold property on the installment basis in prior years, the deferred gain may not be shown on its ending balance sheet. Care must be taken to check prior year returns for installment sales. This item is particularly important if no reorganization occurred.

If the corporation merges with a California corporation, the income remains deferred. However, if the California corporation merges with an out of state corporation, CR&TC §24672 applies and we can accelerate the income.

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## 15180 ACCOUNTS RECEIVABLE

Accounts receivable that were earned by a cash basis corporation, before the distribution in liquidation, are taxable under §24651(b) of the California Revenue and Taxation Code.

If a final return reports zero gross receipts, but the balance sheet reports accounts receivable on the beginning balance, a statutory NPA maybe issued. It may be necessary to write to the corporation and request the amount of account receivable not previously reported as income by the corporation, which were distributed to the shareholders.

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## 15190 GAIN ON DISTRIBUTION OF ASSETS

§336 of the Internal Revenue Code provides for gain or loss to be recognized by the liquidating corporation on the distribution of property as if the property were sold at its fair market value.

If the corporation has assets remaining in the ending balance of the balance sheet or it cannot be determined if there is a gain or loss on the distribution of assets, it may be necessary to write to the corporation and request a schedule showing the gain or loss on the distribution of property in complete liquidation. The gain or loss is determined as if the property had been sold at its fair market value as of the date of distribution.

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## 15200 SUBCHAPTER S CORPORATION

When an S Corporation sells or distributes property in liquidation, the gain may be subject to a higher tax rate as provided in §1374 of the Internal Revenue Code. The same rules apply to S Corporations as for C Corporations regarding the recognition of gain or loss on distribution of assets.

§453(h) of the Internal Revenue Code provides that, except for purposes of any tax imposed by subchapter S, no gain or loss is recognized by the distributing S Corporation with respect to the distribution of installment obligations. This section does not apply for California corporation purposes since California imposes not only IRC Section 1374 (tax on certain gains and built-in gains tax), but also on entity-level tax. Consult your lead before opening any issues on an S corporation.

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## 15210 BAD DEBT RESERVE

If an amount is received by the corporation through the sale or other disposition of its account receivable, in excess of their "net tax basis," such income is taxable in the last year that the corporation is subject to tax. "Net tax basis" equals face value less the bad debt reserve.

When there is a reorganization or merger, bad debts need not be included in income.

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## 15220 NET OPERATING LOSS

Corporations frequently claim 100% of losses when only 50% are allowable. They also forget that "previously ineligible" NOLs expire before the normal 5 years, and that the new "ESB" guidelines only apply to corporations with losses after 1/1/94. For more information on NOLs, see **MATM 8000**.

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## 15230 DEFINITIONS

- Liquidation - Corporation disposes of its assets and liabilities. Incorporation and Dissolution - Formal action of domestic corporations through the Office of the Secretary of State.
- Qualification and Withdrawal - Formal action of foreign corporations through the Office of the Secretary of State.
- Transferor - A corporation that transfers its assets and liabilities to another corporation.
- Transferee - A corporation that receives the assets and liabilities of another corporation.
- Reorganization - A transaction in which a corporation combines or transfers assets and liabilities or stock and whose business is continued by another corporate entity or management.
- No Reorganization - A transaction in which a corporation distributes its assets and liabilities to stockholders and whose business is not continued by another corporate entity. The corporation is not considered a party to reorganization.

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## 16000 BETS

MAPM 16010 Revenue Codes
MAPM 16020 FTB Unit Codes & Requester Codes
MAPM 16030 Pre-NPA Procedures
MAPM 16040 Create A Notice On BETS
MAPM 16050 Preview A Notice On BETS
MAPM 16060 Change A Notice On BETS
MAPM 16070 Delete A Notice On BETS
MAPM 16080 How To Change A Manually Assessed Penalty On BETS
MAPM 16090 How To Change A System Assessed Penalty On BETS
MAPM 16100 Create A Corporate Assumer Relationship On BETS
MAPM 16110 Create An Individual Assumer Relationship On BETS
MAPM 16120 How To Change The Sol Date In * * *On BETS
MAPM 16130 Viewing Notices In The History List On BETS
MAPM 16140 Post–Notice /BETS Affirmations
MAPM 16150 Post-Notice /BETS Revision
MAPM 16160 Post-Notice/BETS Withdrawals
MAPM 16170 Post-Notice - Converted - Affirmations On BETS
MAPM 16180 Post-Notice - Converted - Revisions On BETS
MAPM 16190 Post-Notice - Converted - Withdrawals On BETS
MAPM 16200 Manual Processing

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## 16010 REVENUE CODES

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## 16020 FTB UNIT CODES & REQUESTER CODES

Each field office and central office unit has a separate reporting unit code. These codes can be useful in the following situations:

- When viewing an NPA, the first three digits of the revenue code identify which unit issued the assessment.
- You receive out information from a tax return request.

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## 16030 PRE-NPA PROCEDURES

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## 16040 CREATE A NOTICE ON BETS

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## 16050 PREVIEW A NOTICE ON BETS

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## 16060 CHANGE A NOTICE ON BETS

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## 16070 DELETE A NOTICE ON BETS

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## 16080 HOW TO CHANGE A MANUALLY ASSESSED PENALTY ON BETS

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## 16090 HOW TO CHANGE A SYSTEM ASSESSED PENALTY ON BETS

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## 16100 CREATE A CORPORATE ASSUMER RELATIONSHIP ON BETS

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## 16110 CREATE AN INDIVIDUAL ASSUMER RELATIONSHIP ON BETS

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## 16120 HOW TO CHANGE THE SOL DATE IN R207 ON BETS

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## 16130 VIEWING NOTICES IN THE HISTORY LIST ON BETS

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## 16140 POST-NOTICE/BETS AFFIRMATIONS*

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## 16150 POST-NOTICE/BETS REVISION

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## 16160 POST-NOTICE/BETS WITHDRAWALS

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## 16170 POST-NOTICE - CONVERTED - AFFIRMATIONS ON BETS

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## 16180 POST-NOTICE - CONVERTED - REVISIONS ON BETS

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**The information provided in the Franchise Tax Board's internal procedure manuals does not reflect changes in law, regulations, notices, decisions, or administrative procedures that may have been adopted since the manual was last updated**

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## 16190 POST-NOTICE - CONVERTED - WITHDRAWALS ON BETS

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## 16200 MANUAL PROCESSING

Certain situations require manual rather than BETS processing. Below is a list of situations for which manual processing is required:

- Authorized Offset cases where the net tax amount is a refund.
- Short statute cases – within 30 days
- When system problems are encountered

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# 17000 OTHER PROCEDURES

MAPM 17010 Bill Analysis
MAPM 17030 Multistate Tax Commission Requests
MAPM 17040 Other State Tax Agencies Requests For Information

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## 17010 BILL ANALYSIS

Bill analysis is the only opportunity to review pending Legislation that may impact audit's workload or may create inconsistencies in the tax law. In analyzing a bill, auditors need to:

- Consider and explain its impact,
- Identify all assumptions and data sources, and
- Present any other reasoning applied in drawing your conclusions.

The analysis should generally follow the outline shown below.

- Begin by reading the bill text first. By reading the bill you will gain a general understanding of each section of law. It may be beneficial to take notes, including questions about areas that are unclear, and make corrections to grammar or spelling.
- Compare the legislative intent language and the language of the proposed law changes in the bill to determine whether the language in the bill technically accomplishes the author's intent or if something else would occur as a result of the bill. If you believe the intent is not met or the bill would create unintended consequences, it is your responsibility to point that out.
- Complete the Contact Response * * * * * * * * * * * * *.
- Submit the Contact Response containing the program analysis, via a separate email, to the LSB Analyst, MSA Bill Analysis Coordinator, and Bill Analysis Coordinator's Assistant by the specified date.

You will receive the bill analysis via email from your unit contact person if it is an original bill, or from the MSA Bill Analysis Coordinator or MSA Bill Analysis Coordinator's Assistant if it is a previously assigned bill that is now being amended or if it is a review of the LSB Analyst's summary.

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## 17030 MULTISTATE TAX COMMISSION REQUESTS

The Multistate Tax Commission (MTC) is an organization of states created for the purpose of bringing some order to the state taxation of multistate businesses. Member states pool their resources to select candidates for corporate income, sales and use, franchise and gross receipts tax audits. The MTC audit staff carries out these audits just as though they were part of a state's own audit staff, forwarding their findings and recommendations to the member states for assessment and collection at the completion of the audit.

The disclosure of confidential tax return information is authorized to the MTC for tax purposes only. Employees authorized to disclose information to the MTC* * * *

## 17040 OTHER STATE TAX AGENCIES REQUESTS FOR INFORMATION

Other States' requests for information can only be provided by designated employees here at the Franchise Tax Board. Franchise Tax Board designees are authorized to receive, request and disclose confidential tax information with those states with which we have agreements, where they also have designees. * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * * at the FTB and other states who are designated to receive and disclose confidential tax information.

For more information on confidentiality and disclosure, see **MAPM 2000**.

**NOTE:** ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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## 18000 AUDIT TOOLS

MAPM 18010 Telephone Calls
MAPM 18020 Facsimile Usage (Fax)
MAPM 18025 Power of Attorney
MAPM 18030 Taxpayer Requests Copy Of Corporation Return
MAPM 18040 Taxes Administered - Franchise Tax Non-Qualified Corporations
MAPM 18050 Corporation Identification Number
MAPM 18060 Common FTB Addresses
MAPM 18070 Express Mail
MAPM 18080 Research Procedures
MAPM 18090 Outsearch
MAPM 18100 Research And Reference Guide

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## 18010 TELEPHONE CALLS

Auditors are required to answer telephone calls. The calls may be either a general question concerning the application of the California Revenue and Taxation Code or inquiries concerning a problem involving a specific taxpayer. NOTE: WE DO NOT ACCEPT COLLECT CALLS.

In the case of general questions, the auditor will normally be able to answer the question that is being asked; however, if not certain of the correct answer, refer the call to the appropriate unit.

If the caller's question cannot be referred to a specific unit, refer the call to your lead or supervisor, or obtain the caller's telephone number and call back with the answer.

In the case of inquiries involving an audit problem with respect to a specific taxpayer, it is seldom possible to give an adequate answer without first reviewing the taxpayer's file to determine the particular data that has been requested. Obtain the caller's telephone number and tell the caller that you will review the case and call them back. When discussing a case under audit, an Audit Public Contact Memo must be recorded showing the caller's name, telephone number, the exact corporate name, the corporate number (if known), and a brief summary of the information that is requested or discussed.

If the corporation has been suspended and the question involves the payment of back taxes in order to revive the corporation, the call should be transferred to or referred to the Revivor Unit.

Requests for information concerning the taxpayer address, the names and addresses of any of the corporate officers or similar information may be referred to Data Services.

For information on what can be disclosed during a telephone conversation, see **MAPM 2020**.

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## 18020 FACSIMILE USAGE (FAX)

The auditor may receive a FAX by two methods: as an Email FAX message via the PASS server or on the unit's FAX machine.

The PASS desktop provides the ability to electronically transmit documents between Audit staff and tax filers using a facsimile system (FAX) for the transmission and reception of document images. The PASS Desktop provides FAX capability in two ways 1) when working on a laptop, auditors are able to send faxes using Microsoft FAX; and 2) when connected to the PASS Desktop network, auditors are able to send/receive faxes using the PASS FAX server. Auditors are able to send faxes from Microsoft Word or Excel using the "Send" option and specifying a FAX number instead of a user as the destination.

State law protects confidential taxpayer information including, but not limited to, social security numbers, telephone numbers, credit card number. When sending correspondence by facsimile, use a cover sheet to protect this information.

Remember faxed or photocopies of waivers are evidence that a taxpayer agrees to extend the statute of limitations. However, unless the auditor receives the original document, a faxed copy is not accepted as anything other than evidence of intent.

### FAXES RECEIVED OR SENT VIA UNIT'S FAX MACHINE

Hard copies of FAX material will be handled as regular correspondence.

The Auditor will record the correspondence as received in the "Received Correspondence Window" of PASS and cancel any ticklers, as applicable.

Select the attachment option to create a WORD document that will act as a placeholder in the electronic file for the paper correspondence. This WORD document may contain any information the auditor determines to be necessary, but at the minimum should include 1) the date the correspondence is received by FTB and 2) a description of the correspondence. (i.e. a five-page letter from representative or a two-page letter from taxpayer and the following attachments.)

NOTE: the event log will indicate the date the letter was recorded in PASS as received, not the actual date the auditor received the letter. Therefore, it is important that the auditor log correspondence as received in PASS as soon as the correspondence is received.

### FAX SENT OR RECEIVED THROUGH PASS

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Auditors, who have access to PASS, have an internal Fax # (916) 843-XXXX in their personal computer. This Fax number should be used so faxed information sent and received will become a permanent document within the taxpayer's PASS audit file.

**SENDING A FAX**

* * * *

Received template. Name the document according to cross-referencing workpaper sections and click OK.

Paste the faxed document into the section <<Place bitmap correspondence here>>. Print the Word document template and place it on top of the printed copy of the FAX correspondence. Save and close the Word document and return to PASS. Complete the From, Subject and Comment fields and click "OK" to close the received correspondence window.

It is now all right to delete the MS Outlook FAX mail message.

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## 18025 POWER OF ATTORNEY

The disclosure of confidential information is authorized only to the taxpayer to whom the information pertains, and the taxpayer's authorized representative. The designation of a representative can be established through the execution of a Power of Attorney. The Power of Attorney – Form 3520 is the general form for obtaining powers of attorney for individuals, corporations, partnerships, LLCs and others. The Power of Attorney authorizes, subject to revocation, the taxpayer's representative to receive confidential information and to act on behalf of the taxpayer in tax matters.

For corporations, a principal officer of the corporation must sign the Power of Attorney. A principal officer is the president, vice-president, secretary, treasurer, and secretary-treasurer. A tax manager is not necessarily a principal officer, so it should be verified who is signing for the corporation. An individual who was a principal officer of the corporation for the tax years under examination, but who is not currently a principal officer may not sign the power of attorney.

The Power of Attorney (Power of Attorney) has been revised several times over the years. An older version of this form contains language that may cause confusion. Side 2 of the Power of Attorney – Form 3520 provides a place for the taxpayer to limit the time the POA remains in effect. Generally, if no time limit is indicated, the POA remains in effect until the taxpayer revokes it or until final resolution of all tax matters stated on the form. However, the 11/93 revision of the form also contained the following language n the time limit section: "If no time limit is specified, this Power of Attorney will be effective for one year from the signature date."

It is important to pay close attention to the language and version of any POA forms used in case files. The Problematic language appears to be only on the 11/03 version and was removed as of the 9/94 revision date. If the older version of the form was used in a file, verify the correct statute date and obtain another POA , if necessary.

### Processing Procedures

As of August 1, 1999, the Franchise Tax Board established a centralized POA database and a POA Unit to handle all the processing and maintenance of POA documents. The unit acts as the department's primary point of contact for handling and tracking POA documents, and maintains paper copies of the documents for an appropriate retention period.

When reviewing a POA document, please keep in mind:

The Department's Taxpayer Signature and Authentication Policy does **NOT** require an original signature on the Power of Attorney if there is no reason to suspect that the form has been forged or is otherwise invalid (FTB Policy File 9140, October 1994. <http://ftbnet/policy/9140.htm>).

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The internet version of the Power of Attorney form (FTB 3520) shows the address of the Power of Attorney Unit. If your taxpayer or representative uses this form, remind them to send the Power of Attorney directly to you, instead of the address on the form. Do not forget to send a copy to the POA Unit within **24 hours** of receiving the POA.

1. Additional addresses for the POA Unit:

If you received a Power of Attorney through the network fax (Outlook), you can forward this directly to the POA Unit using this email address: **"POAFX".**
POA Unit's network fax: **(916) 845-9511**.

- Do not forget to include your contact information in case the POA Unit needs to reach you.

If the POA form is received via the Post Office boxes that are routed through Receiving, they will be date stamped with the received date and forwarded to the POA Unit on daily basis. Note: Receiving does not make copies of the POA .

The POA Unit will key the information to the database within five working days. Faxed POA forms will be keyed within 24 hours.

Anytime an auditor receives a signed POA, they should forward a copy to the POA Unit at MS C-2 or FAX a copy to (916) 845-0523. The copy should be sent WITHIN 24 hours of receipt. The original should be retained for the audit file.

If you receive a POA form directly from a taxpayer or their representative, follow the procedures listed below:

| IF | AND | THEN |
|---|---|---|
| Power of Attorney received is COMPLETE<br>It must include:<br>• authorization for use by FTB,<br>• specific tax years,<br>• representative acts authorized, and<br>• taxpayer signature. | Form is Acceptable:<br>• FTB POA Form 3520<br>• BOE POA Form 392<br>• IRS POA Form 2848<br>• Durable POA<br>• Handwritten POA<br>• Correspondence | • Write or stamp the received date on the POA<br>• Route a copy to POA Unit - (MS C-2)<br>Or<br>• FAX to (916) 845-9511 |

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| | | |
|---|---|---|
| | | **Note:** Retain the original POA, photocopy the POA and mark as "Copy". |
| **Power of Attorney received is INCOMPLETE**<br>The missing information must be obtained from the taxpayer before the Power of Attorney can be effective. | • Taxpayer signature is missing,<br>• Specific tax years are missing,<br>• Representative "Acts Authorized" are missing. | **Once complete:**<br>• Note corrected information on POA form in **GREEN** and initial in top right corner<br>• **Route to POA Unit with "RUSH" handling - MS C-2 or fax document to POA Unit at ext. 0523 with cover note.**<br>**POA unit will enter the POA into the database.** |
| **Requesting Original POA Document** | | Contact the POA Unit. |

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## 18030 TAXPAYER REQUESTS COPY OF CORPORATION RETURN

### Taxpayer Requests Copy Of Corporation Return

Effective July 1, 2003, the Franchise Tax Board raised the fee it charges for providing copies of business entities income tax returns. The fee is to cover our costs of handling requests, copying documents, and postage. (R&TC Section 19561.) The new fee for business entities is a flat $20 per tax return. The new fee is based on the average actual cost of providing this service to taxpayers.

To obtain a copy of a tax return, the taxpayer must:

- Submit a Request for Copy of Tax Return form (FTB 3516). This form is available on our Website at: www.ftb.ca.gov. If the auditor receives a request for a copy of a tax return under audit, the auditor should:
  - Send the fee and the form FTB 3516 to RID Unit Corp MS C-2.
  - Make a copy of the return and provide it to the taxpayer.
- Submit a fee of $20 for each tax return being requested. We will no longer waive the fee for tax returns requested during or after an audit. The only exception for waiving the fee is if the taxpayer is a victim of a designated California State or Federal disaster.

The mailing address for requesting business entity return copies is:

RID Unit Corp MS C-2
Franchise Tax Board
PO Box 1468
Sacramento CA 95812-1468

Requests for copies of audit reports should be referred to the Disclosure Office. See MAPM 2030.

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## 18040 TAXES ADMINISTERED - FRANCHISE TAX – NON-QUALIFIED CORPORATIONS

Corporations which are "doing business" in California and are not incorporated in the state or are not qualified by the Secretary of State are subject to the Franchise Tax. These corporations are identified as "NQFT." These corporations file returns on a voluntary basis and the Business Entity Section, Inventory Control Unit, assigns them a 95 identification number.

Corporations which are not incorporated in California and are not "doing business" in California, but are deriving income from California sources are identified as "NQIT." These corporations file returns on a voluntary basis and the Business Entity Section, Inventory Control Unit, assigns them a 97 identification number.

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## 18050 CORPORATION IDENTIFICATION NUMBER

The 90, 91, 92, 93, or 94 identification numbers assigned by the filing enforcement program do not signify whether a corporation is doing business or deriving income in California. The corporation will be classified as an NQFT or NQIT. The filing enforcement number is not changed unless the corporation is later qualified by the Secretary of State. The corporate number remains unchanged in order to identify the corporation as being part of the filing enforcement program. If it is determined that the corporation is doing business in California, the commencing tax should be assessed without changing the identification number and the classification should be NQFT. These cases may be referred to the filing enforcement auditor or may be examined upon a general audit of the return.

For information on Non-Qualified Corporations, see MAPM 18040.

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## 18060 COMMON FTB ADDRESSES

**General Use:**

**ATTN 347:1[1]:2[2]**
**STATE OF CALIFORNIA**
**FRANCHISE TAX BOARD**
**PO BOX 942867**
**SACRAMENTO CA 94267**

**Protests:**

**FRANCHISE TAX BOARD**
**PROTEST SECTION**
**PO BOX 942857 MS D-12**
**SACRAMENTO CA 94257-5540**

**ADDRESS FOR EXPRESS MAIL:**

**ATTN 347:1[1]:2[2]**
**Franchise Tax Board**
**SACRAMENTO CA 95827**

**MAIL PAYMENTS:**

**FRANCHISE TAX BOARD**
**PO BOX 942857**
**SACRAMENTO CA 94257-0041**

**1: Status of case as HW, TC or RTF**
**2: Auditor's initials**

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## 18070 EXPRESS MAIL

Express mail includes mail delivered by Express Mail - U.S. Postal Service, Federal Express, UPS, etc. Such mail can only be delivered to a physical address and not a post office box number. If at Central Office, the express clerk in receiving will contact the auditor when the auditor receives some type of express mail from a taxpayer or tax representative. This is only true if the taxpayer clearly identified the auditor and the auditor's unit as the recipient.

To ensure that mail is received in a timely manner, request that the taxpayer include the following on the face of the express mail envelope:

- Address
- Mail Stop
- Auditor's name
- Unit number
- Telephone number

At Central Office, the express mail desk is located downstairs, Phase I, coordinates J-4. * * * * * * * * * * * * * * * * *

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## 18080 RESEARCH PROCEDURES

The auditor must attempt to resolve issues before they reach the protest level. Audit recommendations must conform to established laws and legal interpretations. The following is a procedure for meeting the research requirements that may vary depending on the audit:

1. Identify potential issues early in the examination of the return. Review prior year audit files or tax returns to identify issues not reported on current return. Obtain prior cycle business knowledge from the previous auditor.

2. Make sure you gain an overview of the subject and understand what facts or documents will be needed to resolve the issues. Do this by referring to MATM and the Guidebook to California Taxes or CCH, or other sources. Lexis/Nexis may help with background information and current legal developments. Consult with other staff who have dealt with this issue if possible.

3. Get the facts by examining relevant documents, asking questions, and obtaining information. The facts must be written down to provide an audit trail and a basis for your decision. Issue written Information Document Requests (IDRs), utilizing a single question IDR format, or where appropriate, a single issue format. Relevant documents must be copied and included with your report and referenced in a manner that will permit their later retrieval.

4. For issues dealing with California Law, read the law and any applicable regulations. Where California Law is substantially the same as Federal, use the Federal Tax Reporter or any on-line service to gain an understanding of the Federal Law.

5. Follow-up on material read. List particular rulings and cases, which from their summaries are relevant.

6. Keep a record of all research and inquiries whether they were successful or not.

7. Not every case will be relevant to your issue. Learn to skim the cases. Read the headnote, then skip to the opinion. Usually the opinion will summarize the facts and reveal whether the case is relevant.

8. When you find a case that pertains to the issue, study the facts in detail. Do not rely on headnotes and editorial abstracts.

9. Sometimes you must evaluate conflicting cases. A more current case carries more weight since presumably the court will have considered the previous decisions. Sometimes a theory or concept is developed, expanded or limited over the years by many court decisions.

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10. Determine how the issue should be resolved. At this point, review what you have done to determine if:

    **a.** The facts obtained pertain to the issue.
    **b.** There are other alternative courses of action.
    **c.** Additional facts or additional audit activity is required.

11. Discuss your determination with the representative. Whenever possible, have the taxpayer and/or representative cite cases that support their position. Sometimes cases both support and disagree with their position. Inform the representative that you have considered all the relevant cases.

12. Consider other sources, technical manuals, etc. – do not quote manuals as support for an adjustment.

13. Decide how you will handle the issue. Discuss your decision with the representative. If there are multiple issues being examined, prepare an AIPS for each material adjusted issue and present each AIPS to the representative as each issue is resolved. At the end of the audit, inform the representative of audit's recommendations in a closing letter and obtain their final position, in writing if possible.

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## 18090 OUTSEARCH

If you cannot locate the return from the "CHARGED TO" information on FTB 6237, wait 30 days and request again. If you still get the same "CHARGED TO" information, you may have the return outsearched. To outsearch, DSS staff actually looks through stacks of returns located in various units and otherwise use detective work to locate the return.

### TO REQUEST AN OUTSEARCH:

**1.** Write "OUTSEARCH" bold RED letters on the FTB 6237 with the "charged to" information on it. Include information regarding who you talked to in trying to locate the return(s).
**2.** Your supervisor approves and signs the request.
**3.** Send to DSS.

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## 18100 RESEARCH AND REFERENCE GUIDE

The official way to cite any section in Part 10 (PIT), Part 10.2 (Administrative), Part 10.5 (Senior Citizens Property Tax Assistance), Part 10.7 (TBOR) or Part 11 (Corp) is Revenue and Taxation Code or Rev. & Tax. Code (Per the California Style Manual used for California Courts and Lawyers.

Informally (which applies to most of our work), anything in Part 11, Division 2, of the Revenue and Taxation Code (Section 23001 – 25141) can be cited as the Corporation Tax Law or CTL (see Section 23001). Before 1/1/2002, this part could be cited as the Bank and Corporation Tax Law or BCTL.

With regards to the Administrative Code (part 10.2 – Sections 18401 –19802) of which penalties and statutes of limitation are part of, there is no special informal abbreviation. Therefore, any sections from this part of the code should be referenced as Rev. & Tax Code or RTC.

## FRANCHISE TAX BOARD MATERIALS

a. Legal Rulings, FTB Notices, Information Letters, Audit Program Reports and Chief Counsel Rulings.

   These constitute the Audit Program Bureau's and Legal Division's interpretations. They can be generated internally or by a request from a representative. These may be cited to representatives except for APR's, which are in-house policies and may not be cited. The reasoning of the reports may be used to support your position.

b. Board of Equalization Decisions

   The Board of Equalization decisions are binding on the FTB. Taxpayers may pay the assessment and file a claim. On denial of the claim they may file in Superior Court.

   Note: Mini decisions made by the State Board of Equalization are not citable.

c. Superior Court, Court of Appeals, California Supreme Court

   California Appellate Courts and California Supreme Court are citable as authority.

d. California Administrative Code (Regulations)

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## FEDERAL GOVERNMENT MATERIALS

The Internal Revenue Service has four interpretative announcements:

a. Revenue Rulings are official interpretations of facts and how law will be applied to those facts.

   IRS is bound by rulings but they do not have the authority of regulations. These can, however, be cited if the facts are the same.

b. Revenue Procedures are administrative practices followed by the IRS. For example, procedure used in changing accounting method.

c. Technical Information Releases (TIR) are not published but can be found in tax services. TIR's are usually after-the-fact rulings requested by the technical staff.

d. Letter Rulings and Technical Advice Memos (TAM) are formal requests by the taxpayer, about specific tax consequences, before a transaction occurs.

## FEDERAL COURT SYSTEM

a. Lowest Level:

   Tax Court
   District Court
   U. S. Claims Court (formerly Court of Claims)

   All decisions are appealable to the next level. The Tax Court and U. S. Claims Court are national courts.

b. Middle Level:

   Court of Appeals
   Court of Appeals for Federal Circuit (U. S. Claims Court)

   All decisions are appealable to the Supreme Court; the Court of Appeals for the Federal Circuit hears appeals only from the U. S. Claims Court.

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c. Highest Level:

Supreme Court

Final appeals are usually granted when there is a conflict between two or more circuit courts of appeals. Denial of a hearing does not necessarily mean the court agrees with the lower courts.

**CITATIONS**

a. Federal
   1. For Supreme Court Cases
      (a) U.S. Reports (U.S.). Example: (1945) 326 U.S. 310
      (b) U.S. Supreme Court reports, Lawyer's Edition (L. Ed.). Example: (1945) 326 U.S. 310, 66, S. Ct. 154, L. Ed. 95
      (c) Supreme Court Reporter (S. Ct.). Example: see b. above
      (d) Cumulative Bulletin (CB). Example: 1940-1 CB 158.
      (e) Commerce Clearing House (CCH) will site as USTC
      (f) Prentice Hall (P-H) will cite as AFTR
   2. District Court, Court of Appeals for the Federal Circuit:
      (a) Federal Reporter (F). Example: (7th Cir. 1965) 354 F.2d 976. Applicable for all years from 1879-1931
      (b) Cases (Fed. Cas.). Applicable for years 1789-1879
      Federal Supplement (Fed. Supp.) Example: (N.D. W.Va.1952) 104 F. Supp. 606
   3. Revenue Rulings:
      (a) In bound form: REV. RUL. 82-11 1982-1 CB 51 The eleventh ruling of 1982 can be found in 1982 Cumulative Bulletin in Volume One at page 51.
      In unbound form: REV. RUL. 82011 1982 2 IRB 7 The eleventh ruling of 1982 can be found in the second Internal Revenue Bulletin issued in 1982 on page 7.
   4. Revenue Procedures (Rev. Proc.)
   5. Tax Court Memos:
      Not officially published, published by CCH and P-H, just as authoritative as regular decisions. CCH cite: TCR: P-H cite: MEMO TC
   6. Tax Court Cases:
      (a) Published only by U.S. government Printing Office, cited as TC, if not yet in bound form, use decision number for example, TC #18.
      (b) Board of Tax Appeals cited as BTA.
      If Commissioner loses a Tax Court regular decision, he will

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acquiescence (a) or nonacquiescence (NA).

b. California
   1. For California Supreme Court:
      California Reports (Cal.)
      California reporter (Cal. Rptr.)
      Pacific Reporter (P.)
   2. For Court of Appeals:
      California Appellate Reports (Cal. App.)
      California Reporter (Ca. Rptr.)
      Pacific Reporter (P.)
   3. Superior Court, Municipal Courts, Justice Courts; None
   4. Board of Equalization Decisions: (SBE)
   5. Legal Rulings: (LR)

c. Access

Most tax services include topical indexes, case tables or citators and regulations finding lists. These give cross-references to the paragraphs in the rest of the volumes called compilation volumes.

The compilation volumes on any particular subject will provide the law and regulation, an explanation, list any court cases or rulings and annotations. Annotations are several sentences serving as a synopsis of the cases or rulings. They are not to be used as authority. If the case or ruling appears to be relevant it should be read thoroughly. Cases cited by representatives should always be examined carefully. Sometimes the representative will misquote or misconstrue cases.

Most tax services also include a volume called New Matters or New Developments. It is always advisable to consult these for any developments on your topic.

d. Order of Citations:

As a case progresses through the various levels of courts, the citation is added to. The order is descending. (The latest decision first.) Example:
U.S. Supreme Court
United States Court of Appeals
U.S. District Court
State Court, etc.

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e. Your Case Citation Should Always Contain
   - Name
   - Volume Number
   - Title of Volume, i.e., TC, USTC, AFTR, etc.
   - Page
   - The Court
   - The Year

**PUBLIC LIBRARIES**

Public libraries carry a great deal of information that may aid you during a field audit. You may be able to find some of the following:

a. Complete 10-K reports for publicly held companies. They may be on microfilm.

b. Proxy statements, which list the various corporate committees, their members, and the number of times they met during the year.

c. Various Periodicals:

   (1) F & S Index of Corporations and Industries. Excellent reference to find articles about corporations.
   (2) Wall Street Journal Index. Yearly index of articles about corporations listed by corporation name.
   (3) Standard & Poors Register of Corporations, Directors and Executives. The three parts have lists of companies by industry, alphabetically, and alphabetic lists of officers and directors, respectively.
   (4) Dun & Bradstreet Reference Book of Corporate Management. Lists companies alphabetically and the officers and directors of each.
   (5) Standard & Poors Corporate Records. Yearly record of Financial Statements, and news of the corporations.
   (6) Moody's Books
   (7) Annual Reports of Corporations
   (8) American Statistical Index. A guide and index to the statistical publications of the U.S. government.

d. CCH State Tax Guide

   Two-volume summary of all 50 states and all taxes that are applicable to each

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state.

e. Federal Tax Coordinator

28-volume set used by businesses to keep current on Federal tax matters.

f. Federal Tax Reporter

g. U.S. Tax Cases

h. Commercial Laws of the World

This contains 27 volumes of commercial laws for every major country in the world. It is useful in preparing a worldwide combined report. For example, it gives rules for depreciation in Australia.

i. Monatti Tax Atlas

This covers all phases of Federal Tax, individuals, partnerships and corporations.

j. Check in the card catalog for other books of interest.

**CALIFORNIA STATE LIBRARY**

The California State Library in Sacramento is a valuable source of information on larger multistate corporations. The State Library has personnel available to perform detailed information searches for state staff at no charge.

If an auditor was researching a corporation in a city library and found a reference to an article that the library did not have, it is more than likely the State Library can obtain a copy of the article from its own reference material or from one of many libraries it has exchange agreements with.

An auditor can call the telephone number listed below and by giving the researcher as specific a request as possible, a synopsis of several articles on the subject can be obtained. The auditor then can determine which articles they need the full text of.

For information requests from computerized databases, the auditor should know the specific time frames the request will cover and have something besides the corporate name to key the request to. Having a major corporate name would cause a very expensive computer search of all articles containing the

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corporate name. If the auditor, for example, provided a division name along with the corporate name the search would be greatly narrowed and the articles would likely be more pertinent.

The State Library is divided into two sections with the following services available:

a. Government Publications Section
   1. How to Use Services
      (a) By Mail:
         Government Publications Section
         California State Library
         P O Box 2037
         Sacramento CA 95809
      (b) In Person:
         California State Library
         914 Capitol Mall
         Room 400, 4th Floor
         Sacramento, CA
      (c) By Phone:
         (916) 445-5156 or (ATSS) 485-5156
   2. Information Available: SEC 10-K's, Annual Reports and Proxy Statements

b. State Information and Reference Center
   1. How to Use Services
      By Mail
      State Information and Reference Center - same address as above
      In Person
      Gillis Hall, Room 309
      Same address as above
      By Phone
      (916) 322-4570 or (ATSS) 492-4570
   2. Information Available
      Indexes to Periodicals, Newspapers, and Government Reports
      Access to Major Computerized Data Bases. All field offices now have on-line access to LEXIS-NEXIS.
      Lexis-Nexis: N.Y. Times from 1969, L.A. Times, and Wall Street Journal from 1975
      Dialog: Time, Business Week, Fortune, Forbes, etc.
      Others: Numerous other databases as explained in the LEXIS-NEXIS users manuals.

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Efficient use of LEXIS-NEXIS may be more cost effective than lengthy library searches or trying to use the state library. * * * * * * * * * * * * * * * * * * * * * * * * * *

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## 19000 PASS

MAPM 19010 Introduction
MAPM 19020 Working Cases in PASS
MAPM 19030 Creating Case Units
MAPM 19040 Case Units Created in Error
MAPM 19050 Requesting Returns
MAPM 19060 Transferring Case Units
MAPM 19070 Working Cases with Different Case Types
MAPM 19080 Activating Bet Notification Flag
MAPM 19090 Check in/Check Out
MAPM 19100 Event Log
MAPM 19110 Case Unit – Key Dates
MAPM 19120 General Information Window
MAPM 19130 Plan
MAPM 19140 Electronic Workpapers
MAPM 19150 Cross-referencing Worpapers
MAPM 19160 Outgoing Correspondence
MAPM 19170 Incoming Correspondence
MAPM 19180 Notice Window
MAPM 19190 Team Audits
MAPM 19200 Informal Review
MAPM 19210 Formal Review
MAPM 19220 Closing Cases
MAPM 19230 Follow-up Flag
MAPM 19240 Printing
MAPM 19250 Par Team Change Requests
MAPM 19260 Time Reporting

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## 19010 INTRODUCTION

The procedures detailed in this section constitute management's requirements and the minimum standards of how to conduct day-to-day audit activities when using the procedures associated with PASS. Use this as a reference tool.

Please note that this section should not be used as a "step by step" guide. A variety of "How To" resources such as the PASS Desktop Help functionality, PASS Tips and the ABTS Help Desk are available for step by step instructions.

PASS provides many benefits. Data analysis will aid in defining the scope of an audit in a timelier manner and assist in developing more effective strategies for the audit. PASS also provides for better case management and will help streamline the audit process.

The PASS Operating System has replaced ACMS with the Management Information Reports (MI Reports). By doing so PASS will be utilized as the Time Reporting and Inventory Tracking System for the entire MSA Audit Program. While it is recognized that PASS does provide for some latitude as to how to work audit cases within the system, the fact that PASS will be used to account for time and track inventory will require a higher degree of uniformity.

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## 19020 WORKING CASES IN PASS

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## 19030 CREATING CASE UNITS

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## 19040 CASES CREATED IN ERROR

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## 19050 REQUESTING RETURNS

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## 19060 TRANSFERRING CASE UNITS

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## 19070 WORKING CASE UNITS WITH DIFFERENT CASE TYPES

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## 19080 ACTIVATING THE BETS NOTIFICATION FLAG

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## 19090 CHECK IN AND CHECK OUT

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## 19100 EVENT LOG

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## 19110 CASE UNIT – KEY DATES

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## 19120 GENERAL INFORMATION WINDOW

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## 19130 TASK PLAN

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## 19140 ELECTRONIC WORKPAPER FILES

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## 19150 CROSS REFERENCING WORKPAPERS

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## 19160 OUTGOING CORRESPONDENCE

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## 19170 INCOMING CORRESPONDENCE

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## 19180 NOTICE WINDOW

The actual notice that is sent to the taxpayer is created in an external system such as BETS or TI or manually processed. Unless the case is surveyed, every closed case unit should have at least one notice recording how it was resolved. In the PASS Notice Window, there are two sections where users are required to enter data; the Notice Detail Section and the Issues Section.

Notice Detail Section

The following fields should be updated as follows:

- Name - NPA, O/A, etc.
- Notice status - Pending Release
- Tax - All tax amounts are to be entered as positive values (Refer to chart below)
- Penalty - Input penalty figure
- Interest - Interest should only be included when it is received as part of a payment prior to the close of the audit.

* Desk Audit staff should also complete the Notice ID field. The 8-digit NPA number is taken directly from the BETS/TI notice.

Issues Section

The Issues Section tracks the issues for which an assessment is being issued for Audit and Claim Case Unit Types. It is the responsibility of the Auditor or Supervisor to enter this information. **The issue section is only required in the "Primary Case Unit" for MSA purposes.**

Issue – In the Issue field, users are required to select the issue(s) for which adjustments are being made in the final audit determination. Audit Staff should include at a minimum the top three major issues in this section.

Issue Tax Amount – The Issue Tax amount entered is the calculation of the tax for the selected issue. Note: This is not the amount of the income adjustment. These amounts are to be entered as positive or negative values based on the adjustments made in the notice**.** Since MSA is preparing the issue section exclusively in the primary case unit, the total adjustments for the audit cycle should be netted. For example, assume an auditor is working a two-year cycle and recommends the following MIC adjustments:

TYE 12/X1 - $20,000
TYE 12/X2 - $30,000

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In the above example, the auditor would select the MIC category in the issue section and input $50,000 in the issue tax amount for TYE 12/X2. Please also note that there is no need for the issue section of the notice window to tie into the tax portion of the window. Each case unit must have the notice detail completed, however, only in the primary case unit will have the issue section completed.

Credit C/O Amount – The Credit C/O amount entered is the amount of the disallowed credit carryover associated with the selected issue. These amounts are to be entered as positive values.

Loss C/O Amount – The Loss C/O amount entered is the amount of the disallowed loss carryover or deductions associated with the selected issue. These amounts are to be entered as positive values.

TAX CHART -

| **Notice Name** | **Description and procedures** |
|---|---|
| **Claim Allowed** | Used when a claim is being allowed in full. Leave tax amount field blank.<br>If claim is being allowed for more based on a different issue – Create two separate notices - claim allowed and O/A. |
| **Claim Denied** | Used when the claim is being denied in full. Enter the entire claim denial amount as a positive number. |
| **Claim Revised** | Used when auditing a taxpayer's claim for refund and the claim is being partially denied. Enter the denied amount of the claim as a positive number. |
| **Claim withdrawn by taxpayer** | This determination is the result of a Taxpayer who has filed an amended tax return or correspondence requesting a refund and has subsequently voluntarily withdrawn their claim. Leave tax amount field blank. |
| **Tax Return Received** | This determination is the result of an amended tax return that is received as a result of action initiated by the auditor and the return is in compliance with the laws of the State of California. The amended return is accepted for the self assessed amount and generally a NPA is not issued. A NPA is only issued for any tax in excess of the tax reported on the amended return. If a payment is received with amended tax return, then the interest should be included in the Notice window. Enter the amount of tax shown on the amended return and interest if applicable. |
| **No Change** | This determination is the result of an audit CU where the |

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| | taxpayer's return is accepted as filed after audit examination. Leave tax amount field blank. |
| **NPA** | Enter the amount of the NPA. - NPAs are driven by document number, so anytime you do something to the tax, you will enter the revised tax. |
| **NPACA** | Used when the audit results in no additional tax, but reduces a carryover item. Enter the amount of the Credit c/o disallowed or the amount of the Loss c/o disallowed. |
| **O/A** | Audit resulted in a refund. Enter amount of refund. |
| **Self Assessed Tax** | This determination is the result of an amended tax return that is received reporting additional tax due. The amended return is filed without any action initiated by the Department. Used mainly with RAR adjustments. Enter amount of self-assessed tax. |

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## 19190 WORKING TEAM AUDITS

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## 19200 INFORMAL REVIEW

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## 19210 FORMAL REVIEW

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## 19220 CLOSING CASES ON PASS

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## 19230 FOLLOW-UP FLAG PROCEDURES

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## 19240 PRINTING

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## 19250 PAR TEAM AND CHANGE REQUESTS

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## 19260 TIME REPORTING

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